

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the Matter of

AT&T Corp. and SBC Communications
Inc. Application Pursuant to Section 214
of the Communications Act of 1934 and
Section 63.04 of the Commission's
Rules for Consent to the Transfer of
Control of AT&T Corp. to SBC
Communications Inc.

WC Docket No. 05-65

Reply Declaration

of

LEE L. SELWYN

on behalf of

CompTel/ALTS

May 10, 2005

REPLY DECLARATION OF LEE L. SELWYN

EXECUTIVE SUMMARY

Unlike each of the five previous RBOC mergers – SBC/Pacific Telesis, Bell Atlantic/NYNEX, SBC/SNET, SBC/Ameritech, and Bell Atlantic/GTE – the proposed SBC/AT&T merger would combine firms that are both *horizontal* competitors in *overlapping* geographic footprints and that engage in upstream and downstream *vertical* transactions with each other. This merger therefore presents even more serious anticompetitive risks than the past mergers, both within and outside the thirteen-state SBC ILEC region.

There is no reason to believe that SBC would be any more likely to willingly compete out-of-region after its merger with AT&T than it has up to now. The company failed to comply (except at an entirely superficial level) with its commitment in the SBC/Ameritech merger proceeding to pursue an aggressive out-of-region competitive local service entry initiative, despite merger conditions backed by substantial penalties. Indeed, SBC Senior Executive Vice President for Corporate Development James S. Kahan now concedes that SBC is confining its efforts to SBC's "sweet spot" – *i.e.*, its thirteen-state ILEC footprint. All of the rationalizations that Mr. Kahan provides for SBC's decision not to compete out-of-region up to now would continue to apply even after the company acquires AT&T, and so the only real benefit to the Applicants from the merger is increased market power and decidedly less competition. And if both the proposed SBC/AT&T and Verizon/MCI mergers are allowed to proceed concurrently, there are strong reasons to conclude that the net result would be to create *de facto* geographic market allocation as between SBC and Verizon, and in so doing eliminate the competition that presently exists between AT&T and MCI, between these two largest IXC's and the RBOCs, and between the post-merger entities and other market participants.

The present merger also differs from all of the previous RBOC marriages in that, in addition to the extensive horizontal competition that presently exists between SBC and AT&T, the two companies also engage in a broad range of *vertical* transactions both with each other and with other carriers involving both upstream and downstream activities. In order to provide both local and interexchange services to customers located within the thirteen-state SBC local service footprint, AT&T must purchase switched and special access services and unbundled network elements (UNEs) from SBC; in fact, AT&T is SBC's *single largest customer* for these services. Access charge payments to incumbent LECs may represent as much as 80% of the total network costs of producing switched long distance service, and in the range of 50% of the price of long distance services paid by enterprise customers (which primarily utilize special access service).

Once joined with SBC, AT&T would no longer have to “pay” for switched and special access services within the SBC operating areas, a benefit that no other carrier could possibly match, affording the merged entity a formidable competitive advantage vis-à-vis all present and potential rivals. And following the merger, SBC’s cash purchases of interexchange network services from nonaffiliated wholesale IXCs for downstream resale to its end-user long distance customers would be replaced by non-cash intracompany transfers of similar services provided over the AT&T network; again, a benefit no other carrier could match. The very reasons why SBC sees advantage in acquiring AT&T impose formidable competitive *disadvantages* and barriers to rival carriers – including other RBOCs – virtually assuring that the “all distance” US telecom industry will devolve into geographically-based regional monopolies.

In fact, the *vertical* concerns raised by this proposed merger are potentially even more serious than the horizontal expansion. Many competitive and putatively competitive telecommunications service markets, including those in which AT&T is a powerful competitor today, are utterly dependent upon obtaining access to or use of ILEC local distribution and interoffice transport facilities. In the vast majority of cases, these facilities within the SBC local region are owned and controlled on a monopoly or near-monopoly basis by the SBC ILEC operating companies. SBC’s prices for both special and switched access services are far in excess of forward-looking economic cost. For the year ended December 31, 2004, SBC’s realized rate of return on its *embedded* investment in the interstate special access services category was 76.19%; that figure would be even higher if based upon forward-looking economic cost. After the merger, AT&T will no longer be required to “pay” these excessive prices for access within the SBC footprint, while all other rivals would be forced to continue to pay such “tribute” to SBC for the privilege of competing in SBC territory.

If both mergers are allowed, SBC and Verizon will each have achieved a retail market share in the range of 80% or more in mass market in-region long distance services. The two RBOCs will collectively dominate the enterprise market and will likely carve up the enterprise market along RBOC geographic lines. SBC and Verizon each have controlling interests in the two largest wireless carriers, with combined national market shares of 63% and in-region shares that are likely much greater. Both will have achieved vertical integration with national interexchange networks, and will have little or no need for any other carriers’ wholesale interexchange services either in-region or out-of-region.

As a result of this diversion of wholesale demand away from independent wholesale carriers and over to the then-integrated SBC/AT&T and Verizon/MCI networks, the remaining non-RBOC wholesale demand will have been sufficiently diminished as to threaten the continued survival of wholesale carriers. As independent wholesale carriers exit the market, SBC and Verizon will then become the primary sources for wholesale interexchange services. However, having achieved a close-to-80% share of retail long distance, SBC and Verizon will then be in a

position to eradicate the remaining retail service competition simply by refusing to make wholesale services available to long distance resellers – a tactic that SBC and Verizon have already employed with great success in dismantling competition for *local* services. The Joint Applicants’ claim that “it is not in SBC’s interest to abandon AT&T’s wholesale business” thus rings hollow in view of the well-documented history of both RBOCs’ steadfast resistance to providing wholesale *local* services *even where they are required by statute and by FCC regulations to do so*.

When considered together with the pending Verizon/MCI merger, the result of both transactions will almost certainly be a *de facto* geographic market allocation of mass market and enterprise customers as between post-merger SBC and post-merger Verizon. For the very same reason that SBC has found it unprofitable to compete for enterprise customers outside of its thirteen states and has not even tried to compete for mass market services, Verizon has undoubtedly encountered precisely the same conditions in attempting to expand beyond its legacy Bell Atlantic/NYNEX and GTE ILEC serving areas. After its merger with MCI, Verizon/MCI will enjoy precisely the same type of switched and special access competitive advantage within the Verizon “sweet spot” that SBC/AT&T will achieve within the SBC “sweet spot.” Verizon/MCI will not be required to pay cash money for (the equivalent of) switched or special access within the Verizon operating areas, but will be forced to make such payments for access services outside of its region. Verizon/MCI will have the same type of economic incentive to concentrate its efforts in the Verizon region as SBC/AT&T will have for concentrating its efforts in the SBC region.

At the same time, the persistence of supracompetitive switched and special access prices will operate to keep other competitors – including CLECs and the other two RBOCs (i.e., BellSouth and Qwest) – out of both the SBC and the Verizon states. The timing of the two transactions is clearly not coincidental, and the negative impacts upon competition in both horizontal and vertical markets are reinforced and compounded by the two concurrent events. It is thus essential that the Commission consider each of the two pending mega-mergers in this context. The elimination of SBC’s and Verizon’s largest competitors is undeniably beneficial to SBC and Verizon, but the Joint Applicants have failed utterly to demonstrate any benefit to anyone else, to the US telecommunications industry, or to the US economy overall. Although the Joint Applicants have thus far declined to provide the Commission with the necessary data to permit a quantitative evaluation of the proposed merger, when and if such data are ultimately provided, I feel quite certain that the proposed transaction will be found to fall far short of satisfying the “public interest” standard that the Commission is required to apply, or of passing antitrust muster.

For all of the reasons set forth herein, the SBC/AT&T merger should not be allowed to go forward.

REPLY DECLARATION OF LEE L. SELWYN

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- 1 Statement of Qualifications
- 2 Imputation Rules proposed by AT&T in the *RBOC Non-Dominant Proceeding*,
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- 3 SBC Announcements of Success in Acquiring Enterprise Customers

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REPLY DECLARATION OF LEE L. SELWYN

INTRODUCTION

Lee L. Selwyn, of lawful age, declares and says as follows:

1. My name is Lee L. Selwyn; I am President of Economics and Technology, Inc. ("ETI"), Two Center Plaza, Suite 400, Boston, Massachusetts 02108. ETI is a research and consulting firm specializing in telecommunications and public utility regulation and public policy. I have participated in numerous proceedings before the Federal Communications Commission ("FCC" or "Commission") dating back to 1967 and have appeared as an expert witness in hundreds of state proceedings before more than forty state public utility commissions. My Statement of Qualifications is annexed hereto as Attachment 1 and is made a part hereof.

1 2. I have been asked by CompTel/ALTS to review the Joint Application of SBC
2 Communications, Inc. ("SBC") and AT&T Corp. ("AT&T") for FCC approval of their proposed
3 merger, together with the accompanying public interest statement and supporting declarations,
4 and to review the comments and testimony submitted on April 25, 2005 by parties opposing and
5 supporting the proposed merger. I have also been asked to review the Joint Application and
6 associated documents filed by Verizon and MCI in connection with their proposed merger.
7 Based upon the foregoing, I have been asked to respond to the opening comments and testimony,
8 and to offer an opinion as to the potential impact that the proposed combinations will have upon
9 competition in the telecommunications industry.

OVERVIEW OF ISSUES ARISING FROM THE PROPOSED MERGER

Why is the merger of SBC and AT&T different from all previous RBOC mergers?

3. Many parties submitting opening comments have noted the significant difference between the instant SBC/AT&T merger and the previous SBC and Verizon mergers, involving other RBOCs or other ILECs.¹ In fact, each of the five previous RBOC mergers – SBC/Pacific Telesis, Bell Atlantic/NYNEX, SBC/SNET, SBC/Ameritech, and Bell Atlantic/GTE – involved *horizontal* combinations of firms that, while maintaining near-monopoly control of their respective geographic service areas, did not for the most part either compete with each other or engage in upstream or downstream transactions with each other. Their respective service areas were entirely non-overlapping and, most importantly, they did not compete with each other to any measurable degree outside of their own operating areas. All of these transactions ultimately were approved, reducing the number of major ILEC holding companies from eight to four.²

1. See, e.g. Petition to Deny of Cbeyond Communications, Conversent Communications, Eschelon Telecom, NuVox Communications, TDS Metrocom, XO Communications, and Xspedius Communications, April 25, 2005 (“*Comments of Cbeyond et al.*”), at 9-10; also, see generally, Comments of ACN Communications Services, Inc., ATX Communication, Inc., Bullseye Telecom, Inc., Cavalier Telephone Mid-Atlantic, LLC, Cimco Communications, Inc., CTC Communications Corp., Gillette Global Network, Inc D/B/A Eureka Networks, Granite Telecommunications, LLC, Lightship Communications, LLC, Lightyear Network Solutions, LLC, Pac-West Telecomm, Inc., RCN Telecom Services Inc., USLEC Corp., U.S. Telepacific Corp. D/B/A Telepacific Communications, April 25, 2005 (“*Comments of ACN et al.*”).

2. *Applications of Pacific Telesis Group Transferor, and SBC Communications, Inc.*
(continued...)

1 4. In every one of the five previous mergers involving SBC, Verizon, or their predecessors,
2 the respective applicants were quick to emphasize that it was precisely because they did not
3 compete and were unlikely to be *potential* competitors, that their proposed mergers would not
4 diminish competition overall.³ Their argument was, in effect, that if you join two monopolies

2. (...continued)

Transferee, For Consent to Transfer Control of Pacific Telesis Group and its Subsidiaries, Report No. LB-96-32, *Memorandum Opinion and Order*, 12 FCC Rcd 2624 (1997) (“*SBC/Pacific Merger Order*”); *Applications of NYNEX Corporation, Transferor, and Bell Atlantic Corporation, Transferee, For Consent to Transfer Control of NYNEX Cooperation and Its Subsidiaries*, NSD-L-96-10, *Memorandum Opinion and Order*, 12 FCC Rcd 19985 (1997) (“*NYNEX/Bell Atlantic Merger Order*”); *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from; Southern New England Telecommunications Corporation, Transferor To SBC Communications, Inc., Transferee*, CC Docket No. 98-25, *Memorandum Opinion and Order*, 13 FCC Rcd 21292 (1998) (“*SNET/SBC Merger Order*”); *Application of GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee; For Consent to Transfer Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, CC Docket No. 98-184, *Memorandum Opinion and Order*, 15 FCC Rcd 14032 (2000) (“*GTE/Bell Atlantic Merger Order*”); *Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, For Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules*, CC Docket No. 98-141, *Memorandum Opinion and Order*, 14 FCC Rcd 14712 (1999) (“*Ameritech/SBC Merger Order*”).

3. See, e.g. *SBC/Pacific Merger Order*, 12 FCC Rcd 2634; Application of Ameritech Corporation and SBC Communications, Inc. for authority, pursuant to Part 24 of the Commission Rules, to Transfer Control of a License Controlled by Ameritech, CC Docket No. 98-141, *Description and Justification of Merger (Attachment to Application)*, filed on July 24, 1998, at 57-59; *GTE Corporation, transferor, and Bell Atlantic Corporation, transferee, for consent to transfer of control*, CC Docket No. 98-184, *Public Interest Statement (Exhibit A to Application)*, filed October 2, 1998 (“*GTE/Bell Atlantic Application*”), at 24-28. In the *NYNEX/Bell Atlantic Merger*, NYNEX and Bell Atlantic were seen as potential competitors in the New York metro-
(continued...)

1 you just end up with one geographically larger monopoly, but since the merging firms never
2 competed with one another in the first place, there is no diminution of competition. As such,
3 they argued, the transactions did not violate the Department of Justice/Federal Trade
4 Commission *Horizontal Merger Guidelines*,⁴ and the mergers would not result in less
5 competition overall.

6
7 5. In fact, the applicants in each of those mergers had claimed that their approval –
8 particularly the two most recent ones – would actually result in *increased* competition because
9 the post-merger entities would then finally achieve the scale necessary for a serious out-of-region
10 competitive initiative.⁵ To back this up, SBC and Bell Atlantic (now Verizon) each “committed”
11 to pursue an aggressive “out-of-region” local service entry initiative, which SBC described as its
12 “national local strategy.” SBC “committed” to enter thirty (30) out-of-region local markets, and

3. (...continued)
politan area (competitive plans were halted when merger talks began), but the Commission
determined that the merger benefits, given the conditions offered by the applicants, outweighed
this diminished competition (*NYNEX/Bell Atlantic Merger Order*, 12 FCC Rcd 20069).

4. U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines*, available at: http://www.usdoj.gov/atr/public/guidelines/horiz_book/hmg1.html (accessed May 4, 2005).

5. *GTE/Bell Atlantic Application*, at para. 13; *Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, For Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules*, CC Docket No. 98-141, Application of SBC and Ameritech, filed July 24, 1998, at Attachment F and 12.

1 Bell Atlantic (now Verizon) promised to enter twenty-one (21) markets outside of the Bell
2 Atlantic/NYNEX and GTE service areas. In approving the two mergers, the FCC translated
3 these “commitments” into binding merger *conditions*, with the respective post-merger firms to be
4 subject to large fines if the promised out-of-region entry did not take place.⁶ In approving the
5 SBC/Ameritech merger, the Commission also imposed a number of conditions intended to assure
6 SBC’s cooperation in assuring that competitors would have access to its network.⁷ Such
7 “commitments,” promises, and threats of large financial penalties notwithstanding, *none of the*
8 *promised* out-of-region initiatives ever took place except at an entirely superficial level.
9 Significantly, and notwithstanding its threat to impose fines of up to \$1.2-billion in the case of
10 SBC and a varying amount based upon the amount of the investment shortfall in the case of
11 Verizon, the FCC has yet to impose *any* fines or forfeitures upon either company for its failure to
12 meet the out-of-region entry merger conditions.⁸

13
14 6. Indeed, and as I discuss below, in its Application to merge with AT&T, SBC now *admits*
15 that it had concluded that it should confine its efforts to what SBC Senior Executive Vice

6. *Ameritech/SBC Merger Order*, 14 FCC Rcd 14712, 14887, at para. 421; *Bell Atlantic/GTE Merger Order*, at paras. 319-323.

7. See, generally, *Ameritech/SBC Merger Order*, at paras. 354-362.

8. SBC has been subject to a number of forfeitures for its failure to satisfy other merger conditions. See, *Comments of Cbeyond et al.*, at 16-19; *CompTel/ALTS Petition to Deny*, April 25, 2005 (“*CompTel/ALTS Petition to Deny*”), at 62-69. While both companies claim to have satisfied the *letter* of their respective merger conditions, it is indisputable that neither has any real market presence outside of their respective home regions.

1 President for Corporate Development James S. Kahan terms SBC's "sweet spot," i.e., its thirteen
2 state ILEC footprint. Mr. Kahan concedes that SBC has all but abandoned its "National Local
3 Strategy" but, once again, seeks to assure the Commission that *this time* SBC is serious, that if its
4 merger with AT&T is approved, SBC will compete out-of-region. Fool me once, shame on you;
5 fool me twice, shame on me. As I discuss in considerable detail below (at paras. 15-27), the
6 reasons Mr. Kahan provides for SBC's failure to compete out-of-region up to now all would
7 continue to apply even after the company acquires AT&T, assuming it were permitted to do so,
8 since those areas would still be outside the merged company's ILEC-dominated region. Thus,
9 the benefits that the Applicants claim for the merger are likely to be nonexistent, since there is
10 every reason to believe that SBC would be no more likely to willingly compete out-of-region
11 after its merger with AT&T than it has up to now. Moreover, in addition to the competitive
12 harms created by the SBC/AT&T merger standing alone, if both the proposed SBC/AT&T and
13 Verizon/MCI mergers were allowed to proceed concurrently, there are strong reasons to conclude
14 that the net result would be to create *de facto* geographic market allocation as between SBC and
15 Verizon, and in so doing eliminate the competition that presently exists between AT&T and
16 other market participants.

17
18 7. The present merger also differs from all of the previous RBOC marriages in that, in
19 addition to the extensive horizontal competition that presently exists between SBC and AT&T,
20 the two companies also engage in an extensive range of *vertical* transactions both with each other
21 and with other carriers involving both upstream and downstream activities. In order to provide

1 both local and interexchange services to customers located within the thirteen-state SBC local
2 service footprint, AT&T must purchase switched and special access services and unbundled
3 network elements (“UNEs”) from SBC; in fact, AT&T is SBC’s *single largest customer* for these
4 services. Access charge payments to incumbent LECs may represent as much as 80% of the total
5 network costs of producing switched long distance service, and in the range of 50% of the price
6 of long distance services paid by enterprise customers (which primarily utilize special access
7 service). Once joined with SBC, AT&T would no longer have to “pay” for switched and special
8 access services within the SBC operating areas, a benefit that no other carrier could possibly
9 match, given SBC’s unassailable dominance over local exchange and access services within its
10 region, affording the merged entity a formidable competitive advantage vis-à-vis rival carriers.
11 And following the merger, SBC’s cash purchases of interexchange network services from
12 nonaffiliated wholesale IXC’s for downstream resale to its end-user long distance customers
13 would be replaced by non-cash transfers of similar services provided over the AT&T network;
14 again, a benefit no other carrier could match, given SBC’s near-monopoly in its local ILEC
15 serving areas. The very reasons why SBC sees advantage in acquiring AT&T impose formidable
16 competitive disadvantages and barriers to rival carriers – including other RBOCs – virtually
17 assuring that the “all distance” US telecom industry will devolve into geographically-based
18 regional monopolies.

19

1 **The proposed vertical merger poses grave threats to competition, since the SBC ILECs**
2 **possess dominant market power over important upstream inputs that the merged**
3 **SBC/AT&T and other competitors will continue to need to produce downstream retail**
4 **services.**
5

6 8. The proposed SBC/AT&T merger raises serious concerns regarding both horizontal and
7 vertical concentration and anticompetitive effects. With regard to horizontal analysis, SBC and
8 AT&T compete directly with one another in a number of important markets, including all three
9 of the market segments recently identified by the Commission in its *Triennial Review Order*⁹ and
10 *Triennial Review Remand Order*¹⁰: (1) mass market, consisting of residential services and very
11 small business services; (2) small enterprise market; and (3) large enterprise market.¹¹
12 Competitive conditions must be analyzed in each of these three segments separately, and
13 separately by geographic area.¹² In their initial application, SBC and AT&T failed to submit
14 information into the record that would permit an analysis of the horizontal market concerns.

9. *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338; *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-989; *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147 (*TRR Proceeding*), *Report and Order on Remand*, 18 FCC Rcd 16978 (“*TRO*”).

10. *TRR Proceeding, Order On Remand*, 2005 FCC LEXIS 912 (“*TRRO*”).

11. *TRO*, at para. 124.

12. *See, e.g., TRO*, at para. 130; *Comsat Corporation Petition Pursuant to Section 10(c) of the Communications Act of 1934, as amended, for Forbearance from Dominant Carrier Regulation and for Reclassification as a Non-Dominant Carrier*, CC Docket No. 80-634, *Order and Notice of Proposed Rulemaking*, FCC No. 98-78, 13 FCC Rcd 14083 (1998). The Courts have recognized geographic markets in *United States Telecom Association v. FCC*, 290 F.3d at 422.

1 Hopefully, the data that the FCC staff requested the applicants to submit the day before the reply
2 comment due date in this proceeding, along with the supplemental data requested by
3 CompTel/ALTS and others, will help remedy this serious deficit.¹³
4

5 9. The vertical market problems raised by this proposed merger, however, are potentially
6 even more serious. Many competitive and putatively competitive telecommunications service
7 markets including those in which AT&T is a powerful competitor today are utterly dependent
8 upon obtaining access to or use of local distribution and interoffice transport facilities that in the
9 vast majority of cases within the SBC local region are owned and controlled on a monopoly or
10 near-monopoly basis by the SBC ILEC operating companies.¹⁴ When SBC or, if the merger is
11 allowed to proceed, AT&T provides a competitive service such as long distance or Internet
12 access to an SBC ILEC local service customer either out of a separate corporate affiliate or out of
13 a separate business unit within the BOC itself, such access is obtained as an internal corporate
14 transaction, in which no cash changes hands and which has no effect upon the parent company
15 "bottom line." However, when unaffiliated rivals provide the same type of competitive service,

13. See, e.g. *Comments of WilTel Communications, LLC*, April 25, 2005, at 2;
CompTel/ALTS Petition to Deny, at 40; Initial Information and Document Request, Wireline
Competition Bureau, April 18, 2005.

14. In fact, and as the Commission has expressly recognized, even where the access is
provided by a CLEC, the CLEC has the ability to exercise monopoly power with respect to "its
own local service customers." *AT&T Corp., Complainant, v. Business Telecom, Inc., Defendant*,
EB-01-MD-001, *Sprint Communications Company, L.P., Complainant, v. Business Telecom,*
Inc., Defendant, EB-01-MD-002, *Memorandum Opinion and Order*, 16 FCC Rcd 12312 (2001).

1 they are required to expend actual cash money to obtain the required access services from SBC
2 (just as SBC would have to pay the ILEC or CLEC that provides the customer's local service if it
3 sought to provide such competitive services to a customer of another LEC either within its own
4 thirteen state region or outside of it).

5
6 10. SBC's prices for both special and switched access services are far in excess of forward-
7 looking economic cost. When access charges were first introduced in 1984, they were based
8 upon *embedded fully distributed cost*, but today even that standard has been abandoned, and
9 access charges now include substantial economic rents. For example, according to SBC's most
10 recent ARMIS reporting for the year ended December 31, 2004, its realized rate of return on its
11 *embedded* investment in the interstate special access services category was 76.19%; that figure
12 would be even higher if based upon forward-looking economic cost. Switched access charges
13 are also set well in excess of economic cost. Interstate switched access rates are around \$0.0055
14 per minute, and intrastate switched access rates in SBC territory may be as high as \$0.02 to \$0.03
15 per minute or higher. Yet the *cost* to provide a switched access connection, based upon cost
16 studies conducted for purposes of setting local intercarrier call termination rates, are in the range
17 of \$0.001 or less.¹⁵

18
15. As CompTel/ALTS note, SBC has recently introduced a "271 Local Switching Transport Offering" with a local usage charge that may be as low as \$0.0007 (i.e., 7 one-hundredths of one cent) per minute, i.e., about 87% *below* the corresponding interstate switched access rate. See, *CompTel/ALTS Petition to Deny*, at 53.

1 **Excessive special and switched access charges raise competitive problems even in the**
2 **absence of a merger; but an SBC/AT&T merger would make the problem far worse.**
3

4 11. The ability of SBC to force its rivals to pay a “tribute” to SBC for the privilege of
5 competing in SBC territory is exacerbated by its absorption of AT&T which, after the merger,
6 will in effect no longer be required to pay these excessive charges to SBC (since the nominal
7 payments would be, in effect, a pocket-to-pocket transaction among corporate affiliates with no
8 effect on the overall bottom line).
9

10 12. SBC thus enjoys a significant competitive advantage vis-à-vis any rival (including
11 Verizon or other RBOCs) within its ILEC operating territories in that SBC does not pay for
12 access to its own facilities, whereas any rival would have to pay cash *to SBC* in order to provide
13 service to an SBC local service subscriber. Today, this problem is ameliorated, if at all, only by
14 the fact that SBC’s long distance offerings (including all-distance services sold to enterprise
15 customers) are a “start-up” operation that commenced only within the last few years following
16 SBC’s receipt of Section 271 long distance authority; but SBC’s unfair competitive advantage
17 would be substantially compounded were it allowed to acquire AT&T, the oldest and largest long
18 distance carrier.
19

20 13. The Telecommunications Act of 1996 (“1996 Act”) anticipates the problem of RBOC’s
21 unfair competitive advantages in downstream markets due to their market power over upstream
22 local connectivity services, and includes provisions intended to address the vertical market power

1 problem; but unfortunately those provisions, while *necessary*, would not be *sufficient* to address
2 the problem if SBC were allowed to acquire AT&T (a prospect that was unanticipated and
3 seemed unthinkable when the 1996 Act was written and initially implemented). For example,
4 Section 272(e)(3) of the 1996 Act, which remains in full force and effect even after other
5 portions of Section 272 sunset, requires that SBC *impute* into its own long distance prices the
6 same SBC access charges that would be paid by rival carriers. In theory, then, post-merger,
7 SBC/AT&T should be indifferent as to whether it is providing long distance service to an SBC
8 ILEC customer or to a customer of a different LEC where actual cash payments for access would
9 be required. The *fact* that, to date, SBC has chosen not to market is long distances service to
10 customers of other LECs underscores that while the imputation requirement is necessary, it is not
11 sufficient to prevent discrimination. Even if an actual on-the-books accounting transfer is
12 recorded (e.g., as between the long distance affiliate and that BOC from which the access service
13 is obtained), this would be a left-pocketed to right-pocket transaction that has absolutely no effect

1 whatsoever on the SBC parent company bottom line.¹⁶ This is, of course, not the case where
2 actual cash is paid to other LECs.

3
4 14. In the past, AT&T itself has expressed these same concerns. In an *ex parte* filing made
5 in June 2004 in WC Docket No. 02-112, AT&T addressed the inability of existing imputation
6 rules to adequately prevent the RBOCs from subjecting rivals to a price squeeze by
7 simultaneously imposing high access charges while setting retail prices that fail to reflect those
8 same access charge levels. AT&T proposed a specific, and detailed, set of imputation rules that
9 were intended to limit the RBOCs' ability and opportunity to impose these types of price
10 squeezes on their rivals.¹⁷ A copy of AT&T's June 2004 *ex parte* submission is provided as

16. This would not be the case if the SBC ILECs were subject to an effective form of regulation. For example, under a rate of return or other earnings-based regulation, such as the original CC Docket 87-313 LEC price cap plan with earnings sharing, an accounting "payment" from the long distance affiliate or business unit to the BOC for access services would increase the BOC's earnings. Under rate-of-return regulation, those increased earnings would offset the total BOC revenue requirement, driving down prices of other services and keeping earnings at the "authorized" level. Under a price cap plan with sharing of excess earnings, a portion of the additional earnings generated by the accounting transfer would potentially have to be credited to the BOC's customers. But under the current post-CALLS regulatory model, any increase in BOC earnings flow straight to the parent corporation's bottom line. Hence, an "imputed" payment of access charges has the effect of reducing the long distance affiliate's earnings and correspondingly increasing the BOC's earnings by exactly the same amount, producing no net effect at the parent company level.

17. *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112, *2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, CC Docket No. 00-175 ("Non-Dominant Proceeding"), Ex Parte Declaration of Lee L. Selwyn and Covering Letter of AT&T, filed June 9, 2004.

Attachment 2 hereto. It is important to note, however, that these “remedies” were intended to work within the much more competitive industry structure that existed one year ago. It is unlikely that aggressive regulation alone – in the absence of competitive pressure from AT&T and MCI – would be effective at all if these mergers were approved.

The anticompetitive effects of the merger are not offset by any significant benefits, since acquiring AT&T would not substantially affect SBC’s ability to compete out-of-region.

15. While an SBC acquisition of AT&T would eliminate horizontal competition between the two companies within SBC’s ILECs 13-state local region, and would substantially compound the vertical competitive problem posed by the advantage that SBC enjoys in downstream markets in-region in which its ILECs possess market power over upstream services (i.e., local connectivity), the proposed merger would have no competitive benefits outside SBC’s region. Indeed, SBC undercuts its own claim that acquiring AT&T would help it compete for enterprise customers by other statements in its witnesses’ declarations and, more fundamentally, by its own actions.

16. First, SBC’s decision, to date, to confine its retail mass market long distance marketing to SBC ILEC customers only demonstrates that the company recognizes its in-region competitive advantage and is attempting to exploit that advantage to the maximum extent possible. SBC does not actively solicit business from customers located in other ILECs’ facilities footprints either within or outside of its thirteen state region. As noted above, and despite having

1 committed to do so as a condition for approval of its merger with Ameritech, SBC does not
2 actively compete for mass market customers out-of-region or even in areas within its thirteen
3 state operating territory where it would be required to obtain UNEs or access from another ILEC,
4 for which it would have to pay actual cash money. SBC applies the same principle of confining
5 its marketing efforts to its own ILEC footprint in the enterprise market as well, and makes no
6 bones about its geographically limited competitive efforts to pursue and to capture “enterprise”
7 customers with a significant presence within the SBC region. As SBC’s Mr. Kahan has stated,
8
9 ... recognizing our competitive disadvantages with larger business customers that have
10 a significant portion of their locations outside our region, our sales strategies identify
11 and pursue only those accounts that we are best suited to serve ... SBC focuses its
12 attention on competing to provide services to business customers in its “sweet spot,”
13 which refers to businesses with locations predominantly located within SBC’s
14 footprint. That is, SBC typically does not even try to compete for business where
15 more than half of the customer’s locations are out of its footprint or where more than
16 20% of the traffic is international. This eliminates a large portion of potential
17 enterprise customers. Given our relative lack of geographic scope, product portfolio
18 and established reputation among this segment of the market, we do not believe that
19 we will be able to compete effectively for a prime supplier role for the majority of the
20 largest enterprise customers in the foreseeable future.¹⁸
21

22 Characterizing SBC’s thirteen state operating area, which embraces some 43% of the total US
23 population and a comparable share of total US Gross Domestic Product, as constituting a
24 “relative lack of geographic scope” for SBC is like describing Ty Cobb (number one ranked

18. Declaration of James S. Kahan, February 18, 2005 (“*Kahan Declaration*”), at para. 27.

1 lifetime batting average of 0.366) as a “relatively poor” baseball player because he failed to get a
2 hit nearly two-thirds of the time he was at-bat.

3
4 17. Importantly, SBC’s acquisition of AT&T will do little or nothing to actually alleviate
5 the specific concern that Mr. Kahan has expressed, which is SBC’s purported inability to serve
6 enterprise customers *outside of its ILEC footprint*. SBC is the dominant incumbent local
7 exchange carrier in thirteen states that collectively represent approximately 43% of the total US
8 economy.¹⁹ As such, the remaining 57% of the US is, from SBC’s perspective, *out-of-region*.
9 AT&T, on the other hand, is not the dominant incumbent local exchange carrier *anywhere in the*
10 *US*, and by the same logic *the entire country* is, from AT&T’s perspective, *out-of-region*. AT&T
11 has, on numerous occasions – and most recently in comments and declarations submitted in the
12 Commission’s *Triennial Review Remand* proceeding²⁰ – emphasized its utter dependence upon
13 ILEC DS-1 and DS-3 UNEs and special access services in serving enterprise customers, *even*
14 *where AT&T itself owned fiber optic rings or other fiber optic facilities that physically passed in*
15 *front of its enterprise customers’ premises*.²¹ In fact, AT&T has advised the Commission that it
16 currently has direct, on-net connections using its own fiber to approximately 6,500 buildings

19. Bureau of Economic Analysis, United States Department of Commerce, Gross State Product. Available at <http://www.bea.doc.gov/bea/regional/gsp/> (accessed May 5, 2005.)

20. *TRR Proceeding*, Reply Comments of AT&T Corp., filed October 19, 2004.

21. See, e.g., *TRR Proceeding*, Declaration of Lee L. Selwyn on behalf of AT&T Corp., filed October 4, 2004, and Declaration of Anthony Fea and Anthony Giovannucci on behalf of AT&T Corp., filed October 4, 2004 (“*Fea/Giovannucci Declaration*”).

1 *nationwide*.²² Assuming that about 40% or more of these are located within the SBC region (it's
2 probably more than that), SBC's acquisition of AT&T would *at best* afford SBC on-net control
3 of access to only about 3,900 buildings *outside of the SBC region*. Even after acquiring AT&T
4 and integrating all of AT&T's network and operations into its own, SBC will still have to pay
5 cash for out-of-region access services, something that it has up to now been unwilling to do.

6
7 18. SBC, in its *Public Interest Statement*, contends that it faces vigorous competition from
8 CLECs, IXC's, and even entities such as systems integrators, equipment vendors, and value-
9 added resellers.²³ This contention severely undercuts Mr. Kahan's attempt to portray SBC as an
10 ineffective or inconsequential competitor for the business of large enterprise customers as
11 support for the Joint Applicants' contention that the merger will not diminish competition in this
12 segment. Indeed if, as Mr. Kahan would have the Commission believe, SBC, an ILEC with
13 44.8-million lines, with 62,700 employees, with a total market capitalization of \$77.7-billion,
14 and which serves an area in which 220 of the Fortune 500 are headquartered, nevertheless lacks
15 the scale and scope to compete effectively for enterprise customers without also acquiring
16 AT&T, then any claims as to the potential competitive challenges coming from CLECs and IXCs
17 that are smaller in scale and scope than SBC not to speak of network integrators and other
18 entities with no network facilities at all must be dismissed as nothing short of pure sophistry.

22. *Fea/Giovannucci Declaration*, at para. 44.

23. See, generally, Description of the Transaction, Public Interest Showing, and Related Demonstrations, February 21, 2005 ("*Public Interest Statement*"), at 68-69.

1 19. Mr. Kahan concedes that SBC has been and is competing head-to-head with AT&T for
2 enterprise customers, at least with respect to mid-sized businesses with most or all of their
3 premises within the SBC footprint. Numerous regional and statewide businesses provide perfect
4 opportunities for SBC to compete, even if it does not want to compete out-of-region. SBC and
5 Mr. Kahan, in claiming that SBC and AT&T do not compete with one another, simply ignore
6 this entire mid-level business segment – where SBC has a significant advantage, and where SBC
7 announcements indicate it has made substantial headway.²⁴

8
9 20. Instead of focusing upon the substantial areas where SBC has seen competitive success
10 and competes vigorously for customers, Mr. Kahan characterizes SBC's areas of strength as
11 minuscule, and as "excluding large portion of potential enterprise customers."²⁵ Mr. Kahan notes
12 that SBC does not *even try* to compete for customers outside its "sweet spot" of business
13 "predominantly located within SBC's footprint."²⁶ Of course, there is no clear reason why SBC
14 has chosen to limit its customers in this way except if serving such customers would be
15 unprofitable. Of course, were that the case, then there would be no possibility that any carrier
16 *smaller than SBC* could successfully compete with the incumbent LEC in such areas. If SBC is
17 capable of providing service to customers with 49% of their facilities outside of the SBC in-

24. See Attachment 3, containing SBC announcements of success in acquiring business customers in recent months.

25. *Kahan Declaration*, see fn. 18, *supra*.

26. *Id.*

1 region area, it is certainly *capable* of competing for customers with higher percentages (including
2 100%) of premises out-of-region – as, indeed AT&T and all other non-ILEC enterprise
3 competitors do. It is simply impossible to square the fact that SBC has elected *not to compete* for
4 these out-of-region customers with the notion that competition – or even “potential competition”
5 – from non-ILECs is rampant. Indeed, AT&T is SBC’s *single largest competitor* for enterprise
6 customers, and elimination of AT&T as a competitor will significantly increase market
7 concentration in the enterprise segment.

8
9 **SBC’s decision not to compete out-of-region also reflects the significant operational**
10 **advantages it enjoys by virtue of its control of integrated facilities in-region, advantages**
11 **that will be conferred upon AT&T if the merger is allowed.**
12

13 21. Mr. Kahan attempts to portray SBC’s “disadvantages” of operating out-of-region as
14 related to its lack of integrated facilities. Mr. Kahan states:

15
16 SBC has sought since the late 1990s to become a significant provider to enterprise
17 customers at the national level. In support of that objective, SBC began in 1999 to
18 make substantial investments to expand its geographic reach and the scope of its
19 products and services to appeal to large national enterprise customers.”²⁷
20

21 Mr. Kahan laments, however, that SBC has been less than successful in pursuing this goal:
22

27. *Id.*, at para. 23.

1 We have so far spent in excess of \$1 billion over five years comprising facilities, start-
2 up sales and marketing costs, and introduction of SBC's products. Still, we find it very
3 difficult to win a prime supplier role for large enterprise customers ...²⁸
4

5 Given that SBC could potentially face fines totaling \$1.2-billion for failing to fulfill its
6 (Ameritech merger) commitment to enter thirty (30) out-of-region local markets, an investment
7 of \$1-billion spread over five years and across those same thirty markets should not impress.²⁹
8

9 22. SBC's assertion that it cannot compete effectively out of region without purchasing
10 AT&T's pre-existing facilities-based network is severely undercut by SBC's successes, to date,
11 in competing for mass market and enterprise customers using a pure *resale* business model for its
12 in-region its long distance services. SBC does not own an interexchange network capable of
13 meeting the needs of large enterprise customers and has not made the investment necessary to
14 acquire such a network; rather, SBC relies primarily on its close relationship with WilTel.
15 Despite SBC's successes in this method of market entry, the highly competitive wholesale
16 market for the services it requires, and the fact that some type of resale is used by most
17 competitors providing enterprise services (as discussed below), SBC is here claiming to have
18 concluded that without a network of its own it cannot compete.³⁰ SBC's rather disingenuous
19 solution to this problem is not to build its own network, but rather to acquire its principal rival

28. *Id.*, at para. 24.

29. See fn. 5, *supra*.

30. *Kahan Declaration*, at para. 25.

1 for the enterprise customers' business. Mr. Kahan states, "[w]e have come to realize that
2 acquisition of a firm that has the strengths and resources we lack is far more prudent than
3 incurring the massive investment and time that, without a substantial likelihood of return in a
4 reasonable period of time, would be required to develop them independently."³¹

5
6 23. SBC's claimed "competitive disadvantage" from its current service method relates to
7 network integration. According to Mr. Kahan,

8
9 Large business customers ... are often hesitant to award SBC major contracts because it
10 [SBC] cannot guarantee its ability to manage and control the networks over which the
11 service is provided. The reason for this reluctance is that on-net traffic is better
12 controlled by the primary network provider; there is less opportunity for delays or
13 trouble at network-to-network interconnect points, less risk of missed orders or
14 provisioning delays between networks, and on-net providers can control all of the
15 network elements and give the highest degree of accountability and performance,
16 among other reasons.³²
17

18 So if all that SBC wanted was a network of its own – the absence of which, according to Mr.
19 Kahan, is a key obstacle to SBC's ability to attract large enterprise customers – it could have
20 insisted that any wholesale carrier with which it does business provide full end-to-end testing
21 capability and establish systems and procedures to identify the precise source and location of any
22 network problem and the precise manner by which the necessary remedial actions will be taken.

31. *Id.*, at para. 23.

32. *Id.*, at para. 25, citing Declaration of Christopher Rice, at paras. 6-8.

1 In fact, SBC already has established precisely such a relationship with WilTel. Indeed, a merger
2 with AT&T that does not also involve the (post-merger) establishment of the very same types of
3 systems and procedures will do nothing more to address the enterprise customers' concerns to
4 which Mr. Kahan refers than had the merger never taken place at all. And if end-to-end network
5 integration were the true goal – and assuming that such integration could not be accomplished
6 without actual *ownership* of the local and interexchange networks (itself a rather far-fetched
7 contention, to say the least) – then SBC could simply acquire network facilities. It certainly need
8 not purchase the largest enterprise player and the single largest SBC competitor.

9
10 24. In addition to failing to justify the specific rationale for the purchase of AT&T's
11 network, the fallacy of Mr. Kahan's "integrated facilities" argument for SBC's inability to
12 compete in the enterprise market is illustrated by the success of other non-integrated providers
13 with far less market power than SBC *and with no "in-region" footprint*. As a direct result of the
14 competitiveness of the wholesale market for long-haul facilities, SBC would have the ability to
15 ask for and receive full end-to-end testing capability and extensive testing procedures to establish
16 the precise source and location of any network problem and the precise manner by which the
17 necessary remedial actions will be taken. The extent of end-to-end integration of the resulting
18 SBC services would far exceed the integration available for most IXC's and others providing
19 enterprise service.

1 25. Moreover, even without purchasing AT&T, SBC already has capacities relating to end-
2 to-end network integration and testing that far exceed most other carriers' ability to integrate
3 enterprise networks. AT&T itself explained the reason for this in various submissions in the
4 TRR proceeding and in the special access context. AT&T has presented extensive evidence
5 indicating that SBC and other RBOCs retain overwhelming market power with respect to special
6 access facilities.³³ Fewer than 20,000 competing facilities are available nationwide,³⁴ and IXC's
7 and other competitors are required to come to the RBOCs for provisioning of special access
8 facilities. These companies have very limited ability to demand end-to-end testing, on-time
9 provisioning, and other services that Mr. Kahan cites as essential to enterprise customers. In
10 fact, evidence from Section 272 Audits indicates that SBC's provisioning of these types of
11 services to its competitors in-region in many cases lags far behind the service it provides to
12 itself.³⁵ The integration problems being faced by non-ILEC competitors are exactly the same as
13 those that SBC faces in places where it is not the ILEC (for example, in the Verizon region), a

33. For example, see fn. 62, *infra*. See also, *TRR Proceeding*, Declaration of Joseph Stith on behalf of AT&T Corp., filed October 4, 2004; Declaration of Micael R. Lieberman and Robert Panerali on behalf of AT&T Corp., filed October 4, 2004.

34. Lee L. Selwyn, Susan M. Gately and Helen E. Golding, *Competition in Access Markets: Reality or Illusion, A Proposal for Regulating Uncertain Markets*, Prepared for the Ad Hoc Telecommunications Users Committee by Economics and Technology, Inc., August 2004, at 18 (available at: www.econtech.com/accesswhitepaper.pdf), ("Ad Hoc Committee White Paper").

35. *Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150, Comments of AT&T Corp. on SBC's Section 272 Compliance Biennial Audit Report ("AT&T Texas Audit Comments"), and Declaration of Robert M. Bell on Behalf of AT&T Corp., filed January 29, 2003.

1 fact that may more fully explain SBC's decision not to compete for customers outside of SBC
2 territory.

3
4 26. Mr. Kahan's portrayal of the difficulties that SBC has encountered in competing on a
5 non-integrated basis outside of its ILEC service territories is further undercut by SBC's conten-
6 tions in the Commission's *Triennial Review* and *Triennial Review Remand* dockets that CLECs
7 are "not impaired" in serving enterprise customers without access to ILEC's DS-1 and DS-3
8 facilities as UNEs. There, SBC had argued that "...it is difficult to see how the Commission
9 could find any impairment at all – for any customers, anywhere, at any capacity – without access
10 to ILEC dedicated transport and high-capacity loops or subloops, including dark fiber."³⁶ Indeed,
11 when the Commission, in its *Triennial Review Remand Order* ("TRRO"), disagreed with SBC's
12 claim except in a very limited number of very large ILEC wire centers, SBC proceeded
13 immediately to challenge the Commission's finding in court.³⁷ Yet here, where the shoe is on the
14 other foot and SBC's goal is to achieve further expansion of its already formidable market
15 dominance rather than, as in the TRR proceeding, simply to shut down its rivals, Mr. Kahan now
16 complains that SBC "find[s] it very difficult to win a prime supplier role for large enterprise
17 customers ..." and that this is particularly so for "those business customers with a large portion of

36. *TRR Proceeding*, Comments of SBC Communications Inc., filed October 4, 2004.

37. "USTA, Bells Ask Court to Stay UNE Remand Rules," *TRDaily*, March 8, 2005.

1 their locations outside of [SBC's] region.”³⁸ While obviously trying to avoid using the “i-word,”
2 Mr. Kahan is nevertheless claiming that SBC is, without AT&T, “impaired” in its ability to
3 provide service out-of-region (i.e., as a CLEC in other ILEC territories), while persisting in its
4 contention (in the *Triennial Review Remand*) that far smaller rival CLECs are “not impaired” in
5 their ability to compete with SBC.

6
7 27. SBC's unilateral decision *not to compete out-of-region* underscores just how difficult it
8 actually is for a non-ILEC to compete with an ILEC, but certainly provides no support for the
9 notion that *because SBC does not compete out of region* its proposed merger with AT&T will
10 have no negative impact on competition in the enterprise market. Mr. Kahan's complaints about
11 the alleged difficulties that SBC had encountered does not provide SBC with a “get-out-of-jail-
12 free card,” and certainly does not remove SBC as a potential competitor of AT&T. Indeed, if
13 SBC is not able to compete outside of its “sweet spot” (where it is the overwhelmingly dominant
14 local exchange carrier with a ubiquitous and unrivaled local distribution, switching and transport
15 infrastructure), then the idea that *anyone* would be able to compete with an RBOC can only be
16 pure fantasy. Accepting SBC's contentions as to its inability to compete is tantamount to
17 bringing the nation's experiment with a competitive telecommunications industry to an end.
18 Short of that, SBC's claims must be afforded no merit, and its plan to eliminate, via acquisition,
19 its single largest rival must be rejected.

38. *Kahan Declaration*, at para. 27.

EFFECT OF THE MERGER ON WHOLESALE AND SUPPLIER MARKETS

The vertical integration of the AT&T and SBC networks will diminish competition in the markets for wholesale and retail interexchange services.

28. The opening comments focused principally upon the competitive concerns created by the *horizontal* merger of SBC and AT&T and the resulting ability of the merged entity to leverage SBC's *local* and *access* service monopoly to monopolize the currently competitive interexchange services market.³⁹ However, the proposed merger involves extensive *vertical* integration of what are currently supplier-purchaser relationships whose result will be to diminish competition in wholesale network services and other supplier markets.

29. In contending that they do not compete with one another, the Joint Applicants describe their respective firms as being "complementary," with each providing capabilities, resources and market presence that the other does not presently possess.⁴⁰ "Complementary" is, in the context of the proposed merger, a euphemism for *vertical integration* on a massive scale. The one key aspect of the SBC/AT&T merger that has no direct parallel in any of the previous RBOC marriages is the *vertical integration* that will result when the two companies combine, precisely because of these extensive complementarities. AT&T is SBC's largest single purchaser of

39. *Comments of Global Crossing North America, Inc.*, April 25, 2005; *Comments of ACN et al.*, at 23-45; *Comments of Cbeyond et al.*, at 3-4.

40. *See, generally, Public Interest Statement*, February 21, 2005.

1 services that AT&T requires to serve downstream mass market and enterprise, local and long
2 distance markets. And, while SBC today makes few, if any, purchases of services from AT&T,
3 SBC does purchase massive quantities of interexchange services from other carriers to support
4 SBC's downstream retail long distance business, *most or all of which can and likely will be*
5 *provided by AT&T following the merger.* The consequences for competition *at both the retail*
6 *and the wholesale levels* is all too clear:

7
8 • AT&T will no longer need to "purchase" access services and UNEs for its downstream
9 services within the SBC footprint. While some of these downstream services compete
10 directly with SBC's existing retail offerings and are thus likely to be discontinued, to the
11 extent that AT&T (or what is left of AT&T) continues to provide services within the
12 thirteen-state SBC region, it will have gained a formidable – perhaps insurmountable –
13 advantage over any non-SBC-affiliated rivals, which will have to keep paying "tribute" to
14 SBC for the privilege of doing business within SBC's turf.

15
16 • At the same time, SBC will be eliminating external demand for access that could have
17 supported facilities-based entry by competitive access providers. AT&T and MCI have
18 explained previously how the Bells were able to use vertical contracts to foreclose business
19 from facilities-based rivals and thereby exclude or limit entry. Now they will achieve
20 permanent foreclosure through acquisition rather than through contracts.

1 • SBC currently purchases interexchange network services for resale in its downstream retail
2 long distance business in a highly competitive wholesale market – indeed, SBC would not
3 have been able to pursue a *resale-only* long distance business model if the interexchange
4 market were as concentrated as the local market. However, after the merger, SBC will
5 (presumably) cease making such third-party purchases, and instead utilize the AT&T
6 interexchange network to supply retail long distance services.

7
8 30. Between 1984 and 1997, AT&T's share of the long distance market (based upon
9 operating revenues) dropped from 90.1% to 44.5%. In 1997, when AT&T's market share was at
10 44.5%, MCI had a 19.7% market share, with Sprint at 9.7%, Worldcom at 6.7% and all other
11 carriers combined accounting for 19.8% of the market.⁴¹ Contrast this with the fact that, in the
12 relatively short time that the RBOCs have been providing long distance service,⁴² *RBOC long*
13 *distance shares* at the *retail* level have soared to more than 60% of residential lines within their
14 respective BOC footprints. SBC did not receive Sec. 271 authority in some of its states until as
15 recently as 2003, so its region-wide share (49% as of end-of-year 2004) does not provide an
16 accurate picture of the ultimate “end state” mature market SBC in-region long distance share. In

41. Federal Communications Commission, Common Carrier Bureau, *Long Distance Market Shares*, March 31, 1999, Table 3.2.

42. Verizon in New York was granted the first such authority in December 1999, while the final RBOC 271 grant of authority went to Qwest for Arizona in December 2003. The FCC lists the dates for all of its Section 271 approvals at www.fcc.gov/Bureaus/Common_Carrier/in-region_applications (Accessed May 6, 2005).

1 those SBC states in which the company has been providing long distance service for five or more
2 years (Connecticut and Texas), its shares have climbed to the 60% to 70% range. The last data
3 released by the FCC reports a 2002 year-end AT&T household market share in the Southwest
4 and West Coast of 27.3% and 39.2% respectively.⁴³ While these percentages have likely
5 decreased over the last two years (due mainly to out-migration of AT&T customers to SBC), the
6 likely result of the SBC/AT&T merger would be a combined long distance market share in the
7 SBC BOC operating territory of 80% or more. The numbers are likely to be similar for Verizon
8 and for the Verizon/MCI merger.

9
10 31. The *horizontal* concentration of retail long distance and enterprise services within the
11 SBC footprint, coupled with the *vertical* integration of SBC's local and AT&T's long distance
12 networks, when viewed together with the concurrent vertical merger of Verizon and MCI, will
13 eviscerate the demand for *wholesale* interexchange services. In their response to protests of the
14 Joint Applicants' merger filing before the California PUC, SBC and AT&T seek to dismiss the
15 importance of this issue by suggesting that WilTel, in particular, has taken contradictory
16 positions relative to the wholesale market, suggesting on the one hand that the merger "will
17 remove SBC (and Verizon) as a significant purchaser of wholesale services, and without those
18 purchases, there is not enough business to go around" and on the other hand, "that the transaction
19 may harm competition because, after closing, AT&T may no longer be willing to continue

43. Industry Analysis and Technology Division, Federal Communications Commission, *Statistics of the Long Distance Telecommunications Industry*, May 2003, at Table 15.

1 selling wholesale long distance services to SBC's competitors."⁴⁴ The Joint Applicants' response
2 ignores and seeks to misdirect regulators' attention away from the *dynamic* consequences of their
3 vertical integration, offering instead an entirely *static* – and simplistic – analysis. Contrary to the
4 SBC/AT&T claim, there is no inconsistency here, and both concerns are real and important.

5
6 32. If both mergers are allowed, SBC and Verizon will each have achieved a retail market
7 share in the range of 80% or more in mass market in-region long distance services. The two
8 RBOCs will collectively dominate the enterprise market and, as discussed here and by several
9 commentors, will likely carve up the enterprise market along RBOC lines. SBC and Verizon
10 each have controlling interests in the two largest wireless carriers, with combined national
11 market shares of 63% and in-region shares that are likely much greater. Both will have achieved
12 vertical integration with national interexchange networks, and will have little or no need for any
13 other carriers' wholesale interexchange services either in-region or out-of-region. As a result of
14 this diversion of wholesale demand away from independent wholesale carriers and over to the
15 then-integrated SBC/AT&T and Verizon/MCI networks, the remaining non-RBOC wholesale
16 demand will have been sufficiently diminished as to threaten the continued survival of wholesale
17 carriers. As independent wholesale carriers exit the market, SBC and Verizon will be the
18 primary sources for wholesale interexchange services. However, having achieved a close-to-
19 80% share of retail long distance, SBC and Verizon will then be in a position to eradicate the

44. *Joint Reply of SBC Communications, Inc. and AT&T Corp. to Protests*, California Public Utilities Commission Application 05-02-027, April 29, 2005, at 49.

1 remaining retail service competition simply by refusing to make wholesale services available to
2 long distance resellers – a tactic that SBC has already employed with great success in
3 dismantling competition for *local* services. The Joint Applicants claim that “it is not in SBC’s
4 interest to abandon AT&T’s wholesale business” thus rings hollow in view of the well-
5 documented history of SBC’s steadfast resistance to providing wholesale *local* services *even*
6 *where it is required by statute and by FCC regulations to do so*. Finally, the fact that the FCC
7 had, according to SBC, rejected similar arguments in the WorldCom/MCI merger is inapposite to
8 the present matter, since pre-merger the MCI WorldCom entities supplied only a small fraction
9 of the interexchange volume that AT&T now supplies, and post-merger MCI WorldCom
10 controlled only about 20% of the national long distance market, not even close to the post-merger
11 SBC/AT&T share of at least 80% of in-region mass market and enterprise long distance services!

12
13 **The vertical integration of AT&T and SBC will dramatically increase SBC’s *monopsony***
14 **power over its suppliers.**
15

16 33. As with the previous RBOC mergers, SBC and AT&T also tout, as an additional merger
17 “benefit,” the merged entity’s ability to obtain better prices from its suppliers, such as equipment
18 manufacturers and wholesale network services carriers, in effect, to gain increased *monopsony*
19 *power* with respect to such purchase transactions. This result was not only addressed in each of
20 the previous RBOC merger situations, but was actually presented by the applicants in each
21 instance with a positive *spin*, i.e., as providing a positive benefit to consumers and to the public
22 interest. Specifically, in each of the previous RBOC mergers, the applicants identified as a

1 “merger benefit” the increased purchasing power that the larger firm would enjoy with respect to
2 its purchases of plant and equipment.⁴⁵ Significantly, SBC advances similar expectations of
3 “economies of scale in procurement and deployment” in this case as well.⁴⁶

4
5 34. To be sure, there are economies of scale in procurement of most any type of product or
6 service, but these do not typically increase indefinitely. Ultimately, however, the ability of
7 successively larger firms to achieve lower prices from suppliers is more the result of the large
8 purchasers’ monopsony power than of any scale economies. Economics texts define monopsony
9 power as follows:

10
11 *Monopsony* refers to a market in which there is only one buyer. An *oligopsony* is a
12 market with only a few buyers. With one or only a few buyers, some buyers may have
13 *monopsony power*: a buyer’s ability to affect the price of a good. Monopsony power
14 enables the buyer to purchase the good for less than the price that would prevail in a
15 competitive market.⁴⁷
16

45. See, e.g. *Application of Ameritech Corporation and SBC Communications, Inc. for authority, pursuant to Part 24 of the Commission Rules, to Transfer Control of a License Controlled by Ameritech*, CC Docket No. 98-141, Exhibit 2 to Application, Affidavit of Martin A. Kaplan, filed on July 24, 1998, at para. 20; *Application of Ameritech Corporation and SBC Communications, Inc. for authority, pursuant to Part 24 of the Commission Rules, to Transfer Control of a License Controlled by Ameritech*, CC Docket No. 98-141, Exhibit 2 to Application, Affidavit of Richard J. Gilbert and Robert G. Harris, filed on July 24, 1998 at para. 45.

46. *Public Interest Statement*, at 33.

47. Robert S. Pindyck & Daniel L. Rubinfeld, *Microeconomics 5th Edition*, Prentice Hall, 2001, at 352.

1 If both the SBC/AT&T and Verizon/MCI mergers are allowed to go forward, the two largest
2 telecommunications firms will control some 58% of total US wireline revenues and 60% of total
3 US wireless revenues,⁴⁸ and will have the ability to dictate prices to suppliers of equipment and
4 network services. Additionally, to the extent that these mergers have vertical as well as
5 horizontal components, some existing third-party suppliers may be forced out of the market
6 altogether.

7
8 35. Consider, in particular, the wholesale network services that are purchased by SBC for
9 downstream resale to its retail mass market and enterprise customers. Mr. Kahan states that “to
10 attempt to address its limited geographic presence out of region, SBC has formed strategic and
11 commercial relationships to use third-party networks for transport and local access in areas where
12 we lacked our own network facilities. The most significant of these has been with Wiltel.”⁴⁹
13 CompTel/ALTS member WilTel is primarily a *wholesale* IXC, but WilTel also provides
14 wholesale services to other retail long distance carriers as well as services at retail to enterprise
15 customers. As such, its relationship with SBC puts WilTel squarely in competition with AT&T
16 to the extent that SBC and AT&T *presently* compete for the same retail mass market and

48. This figure is likely extremely conservative because it includes intra-industry purchases of access services, UNEs and services for resale. FCC Form 499-Q Filings, Detailed Revenues by Type of Carrier, 1st Quarter 2004–4th Quarter 2004 (all filers minus wireless service providers); Carrier revenue figures are from UBS Investment Research “Wireline Telecom Play Book,” January 14, 2005.

49. *Kahan Declaration*, at para. 25.

1 enterprise customers. In fact, although Mr. Kahan appears to characterize SBC's use of the
2 WilTel network as providing SBC with *out-of-region* network facilities and services, the WilTel
3 network provides extensive coverage *within* the SBC footprint,⁵⁰ and it is my understanding that
4 WilTel also provides extensive *in-region* services and facilities to SBC and to its affiliates.

5
6 36. Mr. Kahan readily concedes that SBC's acquisition of AT&T will obviate its need to
7 rely upon third-party providers such as WilTel, and that SBC will gain significant competitive
8 advantage in serving large enterprise customers because, while today it "cannot guarantee its
9 ability to manage and control the networks over which the service is provided,"⁵¹ it will
10 following its acquisition of AT&T be able to provide such guarantees and assurances to large
11 enterprise customers when it can integrate the AT&T network into its own.

12
13 37. In so doing, however, SBC will cut off wholesale carriers such as WilTel from the
14 indirect access to SBC's retail customers that such carriers currently obtain via their wholesale
15 services relationship with SBC. Additionally, if Mr. Kahan's recitations as to SBC's difficulties
16 in competing out-of-region are to be afforded any credence, then any wholesale-only carriers
17 would have absolutely no ability to compete in the *retail* mass or enterprise markets with SBC or
18 Verizon because the non-RBOC IXC's have no local service "footprint" at all, and carriers such
19 as WilTel that also provide retail services in the enterprise segment will continue to suffer from

50. See, www.wiltel.com/map/ (accessed May 6, 2005).

51. *Kahan Declaration*, at para. 25.

1 the same difficulty that Mr. Kahan laments with respect to SBC *sans* AT&T, i.e., that “Large
2 business customers ... are often hesitant to award SBC major contracts because it [SBC] cannot
3 guarantee its ability to manage and control the networks over which the service is provided.”
4 Indeed, and as I discuss at greater length at paras. 82-86, *it will be impossible for competition to*
5 *survive in a post-SBC/AT&T merger industry because SBC has no obligation to assure that non-*
6 *affiliated competitors are afforded precisely the same level of access to the core SBC monopoly*
7 *“last mile” local network infrastructure – including local switching and interoffice transport –*
8 *that AT&T will come to acquire through the vertical integration of its and SBC’s network.*

9
10 38. While SBC may *claim* that its integration with AT&T will result in increased efficiency
11 and productivity overall, none of these speculations has been quantified. Moreover, whatever
12 *incremental* efficiency gain that SBC may theoretically experience would be more than offset,
13 from the standpoint of the overall US economy, by the significant loss of competition at both the
14 retail and wholesale levels. Indeed, exerting monopsony power to force down a supplier’s price
15 is *not* an efficiency gain for the economy overall unless the supplier’s *costs* are also reduced, nor
16 are these welfare appropriations merger-specific. If these arrangements are so pro-competitive
17 and efficiency-enhancing, then the Bells could form buyers’ coops, since none competes out-of-
18 region anyway. Moreover, to the extent that the attempt to dictate such price reductions to
19 suppliers forces them to curtail new investment, expenditures on assuring service quality, or
20 ultimately to cease providing the wholesale service altogether, economic efficiency and the US
21 economy overall are decidedly *disserved*.

EFFECT OF THE MERGER ON COMPETITION FOR ENTERPRISE SERVICES

The proposed merger would enable SBC to solidify its monopoly control of upstream markets for dedicated special access services by eliminating AT&T as a special access competitor, and would give the merged company the ability and strong incentives to discriminate against downstream *retail* competitors.

39. A number of commenting parties have focused their attention particularly at the current state of the market for special access and the implications of the merger upon both the (wholesale) special access and downstream enterprise services markets. Global Crossing has provided an econometric model, developed by former FCC Chief Economist Prof. Joseph Farrell, that demonstrates why the geographic scope of the special access services market must be viewed both at a granular, premises-specific level and also at an SBC region-wide level.⁵² Prof. Farrell correctly notes that SBC is the *only* source of special access services to every customer location throughout the SBC footprint. He explains that SBC employs a volume-based pricing scheme in which all of a wholesale customer's purchases of SBC special access services are aggregated for purposes of establishing the applicable discount, and that to receive SBC's pricing arrangement for special access, the customer (an IXC or a CLEC) is required to commit 90% of its total special access demand to SBC, or purchase 90% of its base period demand from SBC, in order to qualify for the discount and/or avoid being forced to incur a penalty.⁵³ As such, in order

52. Statement of Joseph Farrell, Attachment A to Comments of Global Crossing North America, April 25, 2005 ("*Farrell Statement*"), at paras. 30-36.

53. SBC's special access pricing scheme is actually even more complex and onerous than as
(continued...)

1 to meet the minimum volume threshold, special access customers may be compelled to forgo
2 purchasing special access services from a CLEC or CAP competitor – or perhaps even forgo self-
3 supply – even if its price or cost is below that of SBC, if by making such a purchase the customer
4 would then fall below the 90% SBC contract demand threshold. Thus, in view of its absolute
5 monopoly over *some* (in fact, over *most*) of the special access market within its footprint, SBC
6 can – and does – leverage that monopoly to foreclose competition elsewhere even where it may
7 otherwise be economically viable.

53. (...continued)
described by Prof. Farrell. SBC's access tariff FCC -No. 73 actually contains three different
term plans for DS-1 special access services, all of which involve terms that effectively requiring
the purchaser to maintain its existing level of service and to commit least 80% (and in some
cases more than 90%) of their circuit purchases to SBC. Two of the plans, the "Optional
Payment Plan" (OPP) and the "High Capacity Term Payment Plan ("HC-TPP") have not been
available for new purchases since May 2003 (although some circuits are likely still being
purchased under those plans). A review of the current plan, the DS1-Term Payment Plan ("DS1-
TPP"), reveals that customers must commit individual Channel Terminations for periods ranging
from 1 to 7 years, and provides substantial penalties for individual circuit terminations before the
end of the term. Integral to the DS1-TPP plan is a "portability" feature (allowing individual
circuit terminations) that requires purchasers to commit to maintaining between 80% and 125%
of their total DS1 channel termination purchases for a period of three years. If the number of
channel terminations in the plan falls below 80% in any given month, the customer is billed the
channel termination nonrecurring charge ("NRC"), about \$900, for each channel termination
below 80% until such time as the 80% level is achieved. This rate is *seven to eight times greater*
than the \$112 to \$125 monthly channel termination rate that would apply for those circuits under
the DS1-TPP for a three-year term plan. In an even more draconian requirement, if the customer
increases its purchase of channel terminations beyond 124% of the committed level without also
increasing the TPP commitment level, each circuit in excess of the 124% mark is also billed the
\$900 NRC for each channel termination *each month* until the commitment level is adjusted. The
effect of this extreme ceiling penalty is to lock in all growth. (SBC FCC-No. 73, Sections 7.2.19,
7.2.20, 7.2.22, 7.3.10.(F).10.1, and 7.3.10.(F).10.4).

1 40. The type of volume-based pricing device described by Prof. Farrell gives SBC the
2 ability to extend its *de facto* monopoly over most special access services over to the small
3 fraction of the total special access universe where some competitive entry has developed. In
4 addition to this *horizontal* leveraging, such volume-based pricing can also provide a vehicle for
5 SBC to *vertically* discriminate in favor of its own long distance affiliate and against competing
6 carriers. Its acquisition of the largest competing interexchange carrier – AT&T – clearly expands
7 the opportunity for – and benefit (to SBC) from – such conduct. This is not just a hypothetical
8 scenario. In December 2004, the Commission ruled on a Complaint by AT&T Corp. against
9 BellSouth’s so-called “Transport Savings Plan” (“TSP”) for special access,⁵⁴ a volume-based
10 tariff that had a number of similarities to the SBC pricing scheme described by Prof. Farrell.
11 However, in addition to being pegged to the access customer’s commitment to purchase 90% of
12 its “base demand” from BellSouth, the TSP is pegged to the access customer’s *growth* more so
13 than its total *volume* of purchases. As such, the TSP was most beneficial to carriers that were
14 experiencing rapid demand growth, and was actually disadvantageous to carriers that were
15 experiencing no or negative growth, *even if such carriers’ total BellSouth special access*
16 *purchases were actually greater than those of the “growing” carrier.* Because BellSouth’s
17 Section 272(a) long distance affiliate, BellSouth Long Distance (“BLD”), had started out with a
18 base demand of essentially zero (not having initially been authorized to provide in-region long
19 distance service and not having bothered to compete out-of-region), BLD had necessarily been

54. *AT&T Corp., Complainant, v. BellSouth Telecommunications, Inc., Defendant*, File No. EB-04MD-010, *Memorandum Opinion and Order*, FCC 04-278, December 9, 2004.

1 experiencing significant growth in demand (i.e., anything above zero is “growth”) following its
2 receipt of Sec. 271 authority, whereas legacy long distance carriers such as AT&T were actually
3 experiencing a *decrease* in demand as they lost customers to BellSouth. So a discount driven by
4 growth operated to favor BellSouth’s LD affiliate while disadvantaging rival long distance
5 carriers, including those who had been purchasing much larger quantities of service from
6 BellSouth. And in ruling on the AT&T complaint, the Commission found that “[t]he TSP’s
7 disproportional discounts discriminate in favor of BellSouth Long Distance, in violation of
8 section 272.”⁵⁵ The Commission observed that:

9
10 In sum, the TSP accomplishes exactly what BellSouth states it was designed to do: it
11 provides relatively low-volume customers, such as BellSouth Long Distance, with far
12 greater discounts than would be available under a strictly proportional plan, both in
13 absolute terms and in comparison to the discounts provided to relatively high-volume
14 customers, such as AT&T. In turn, as BellSouth acknowledges, the TSP enhances the
15 competitiveness of relatively low-volume customers, such as BellSouth Long Distance,
16 vis-à-vis relatively high-volume customers, such as AT&T.⁵⁶
17

18 * * *

19
20 BellSouth’s own description of the operation of the TSP reveals the TSP’s unlawfulness
21 under section 272 of the Act. The TSP’s discounts substantially favor BellSouth Long
22 Distance and substantially disfavor BellSouth Long Distance’s larger competitors in a

55. *Id.*, caption preceding para. 18.

56. *Id.*, at para. 27.

1 manner that appears to lack any cost basis. Section 272 “flatly” forbids such
2 discrimination.⁵⁷

3
4 41. Although the specific details of SBC’s special access volume discount and contract
5 pricing schemes differ somewhat from BellSouth’s, both provide a compelling *real-world*
6 demonstration of how an RBOC such as SBC may use its access monopoly both to foreclose
7 special access competition in the wholesale market while simultaneously discriminating against
8 downstream *retail* competitors. Prof. Farrell’s conclusion is that, with the merger of AT&T into
9 SBC, this untenable condition can only get worse. Through its 1998 acquisition of Teleport
10 Communications Group (“TCG”), AT&T is now one of the largest, *if not the largest*, competitive
11 provider of high-capacity last mile digital subscriber facilities at the DS-1 level and above
12 connecting to the premises of enterprise customers within the SBC region. Indeed, as Dr. Simon
13 Wilkie (testifying for *Cbeyond et al.*) has noted, elimination of AT&T as a competing provider
14 of special access services will significantly reduce the extent of CLEC presence in many SBC
15 enterprise markets.⁵⁸ For example, absorption of AT&T into SBC would reduce the number of
16 CLEC-served (enterprise customer) buildings in the Cleveland MSA by 53.6%, from 3,039 to
17 1,409.⁵⁹ In the Milwaukee MSA, the number of CLEC-served buildings would drop by 64%,
18 from 3,292 to 1,186, with AT&T out of the picture. Significantly, SBC’s Prof. Carlton in his

57. *Id.*, at para. 29.

58. Declaration of Simon Wilkie on behalf of *Cbeyond et al.*, April 25, 2005, at paras. 18-21, Tables 1 and 2.

59. *Id.*, at Table 1.

1 Declaration for SBC, in citing the *New Paradigm Research Group CLEC Fact Report 2004* as
2 his data source, appears to have *included* buildings served by AT&T.⁶⁰

3
4 42. Although AT&T had itself stated, in its comments in the *TRR* proceeding, that it was
5 not, for the most part, economical for AT&T to provide end user facilities-based connections to
6 its fiber optic networks where the end user's demand was at or below two DS-3s, AT&T/TCG
7 was a significant provider of facilities-based connectivity to larger end users and to other carriers
8 whose demand was at or above three DS-3s. Elimination of AT&T as a competitor to SBC
9 creates even greater concentration in special access than exists at the present time and, as Prof.
10 Farrell has demonstrated, will enable SBC to apply an even larger price penalty where the
11 (wholesale) special access customer fails to meet SBC's 90%-of-demand threshold than it is able
12 to do today, with AT&T in the market.⁶¹

13
14 **Even though AT&T has been subject to precisely the same operational difficulties and**
15 **competitive disadvantages (vis-à-vis the incumbent LEC) that SBC claims to be an**
16 **impediment to its own competitive entry out of region, AT&T has still been successfully**
17 **serving the very customers that SBC now claims it can serve only by merging with AT&T.**
18

19 43. While SBC was electing not to compete except where it also controlled local network
20 facilities as an ILEC, its merger partner AT&T was successfully serving the very customers that

60. Declaration of Dennis W. Carlton and Hal S. Sider, Attached to *Public Interest Statement*, February 21, 2005 ("*Carlton & Sider Declaration*"), at para. 68.

61. *Farrell Statement*, at para. 15.

1 SBC now claims to have been unable to serve. This was the case, despite AT&T's being subject
2 to precisely the same operational difficulties and competitive disadvantages (vis-à-vis the
3 incumbent LEC) that SBC claims to be an impediment to its own competitive entry out of
4 region. AT&T was active in both the *TR* and *TRR* dockets, and provided extensive economic
5 and operational testimony demonstrating its extreme dependence upon ILEC facilities to furnish
6 service to enterprise customers, particularly those at the DS-1/DS-3 level. In addition, AT&T
7 had in October 2002 petitioned the FCC to revisit and to reverse its "pricing flexibility" rules
8 with respect to special access services, noting that in AT&T's experience, special access rates
9 were consistently higher in areas subject to special access pricing flexibility than in areas still
10 subject to price caps.⁶² At about the same time, a group of large enterprise customers, the Ad
11 Hoc Telecommunications Users Committee, advised the FCC that its members had similarly
12 experienced large special access price increases in the so-called "pricing flexibility areas," and
13 that contrary to the *presumption of competition* underlying the grant of pricing flexibility to the
14 ILECs, the members of the Ad Hoc Committee – some of the largest enterprise customers in the
15 country – had themselves encountered no consequential amount of competitive choices that were
16 *available to them* in the so-called pricing flexibility areas or elsewhere.⁶³

62. *AT&T Corp. Petition for Rulemaking To Reform Regulation Of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, Petition For Rulemaking, RM-10593, October 15, 2002 ("*AT&T Special Access Petition*").

63. *Ad Hoc Committee White Paper*, at 17.

1 44. AT&T estimated (in 2002) that of the approximately three million commercial/business
2 customer locations nationwide, it was providing service to approximately 186,000 of these
3 locations using some type of special access service or its equivalent.⁶⁴ Of these, only about 6,000
4 locations were being served directly using AT&T-owned dedicated access facilities, another
5 3,700 were being served using dedicated access facilities being leased from other CLECs, and
6 the remaining 176,300 were being served by ILEC special access services.⁶⁵

7
8 45. Importantly, the RBOCs' own evidence as to CLEC dependence upon RBOC DS-1/
9 DS-3 facilities to serve enterprise customers confirmed and corroborated AT&T's contentions as
10 well as the specific experience of the large enterprise customers as reported by the Ad Hoc
11 Telecommunications Users Committee. In an August 18, 2004 *Ex Parte* submission in CC
12 Docket Nos. 01-138, 96-98, and 98-147, SBC produced a set of extremely detailed maps of the
13 central business districts of approximately twenty major cities within its operating territory that
14 confirm widespread use of SBC special access services by CLECs *even on streets where*
15 *competing fiber optic facilities are portrayed as being in place*. Figure 1 below reproduces
16 SBC's map of the San Francisco financial district, filed with its August 18, 2004 *ex parte*, in
17 which more than 436 instances where SBC special access service is being provided to CLEC

64. *Declaration of Kenneth Thomas on behalf of AT&T*, filed October 15, 2002 with the *AT&T Special Access Petition*, at 1..

65. *Id.*

1 customer locations along streets where competitive fiber is in place.⁶⁶ In fact, an analysis of
2 those SBC maps that separately identify CLEC “on-net” buildings and SBC special access
3 buildings underscores the pervasive use of SBC facilities even in markets that SBC itself
4 considers to be the most competitive of all. Table 1 below presents the results of my analysis for
5 several of the MSAs in SBC’s footprint, which appear to be representative of all of the MSAs for
6 which maps have been provided.

66. SBC August 18, 2004 *ex parte* letter, CC Docket No. 01-338, at Attachment A.



Figure 1. SBC map of Downtown San Francisco showing CLEC enterprise customers being served using Special Access and CLEC “lit” buildings. Source: SBC *ex parte* letter dated August 18, 2004, CC Docket No. 01-338.

Table 1			
Most CLEC enterprise customers are being served using special access, even on streets where CLEC-owned fiber has been deployed			
City	All locations		SBC Spc. Access on streets with CLEC fiber
	SBC Spc. Access	CLEC fiber	
San Francisco (city wide)	1160	71	658
San Francisco (financial dist.)	719	68	436
Oakland	181	18	111
San Jose	95	24	63
Dallas	124	27	109
Source: Analysis based upon SBC August 18, 2004 <i>Ex Parte</i> submission in CC Docket Nos. 01-138, 96-98, and 98-147			

46. The SBC map of the San Francisco financial district (Figure 1) includes *only* customer locations that, according to SBC, *are being served by CLECs either through the use of CLEC-owned facilities (the purple squares) or via SBC special access (the yellow triangles)*; the map does not identify *any* enterprise customers that are being served on a retail basis directly by SBC itself. Taking SBC's information at its face value, a physical count of the squares and triangles reveals that there are approximately 436 instances in the small area included on this map where, according to SBC, the CLEC is using SBC special access *even though there is CLEC-owned fiber passing the customer's building on the very same street.*⁶⁷

67. Given the rather questionable nature of the data sources that were used by SBC in
(continued...)

1 47. Clearly, the proximity of a customer to CLEC-owned fiber is not the controlling factor
2 in the CLEC's economic choice as between using its own already-in-place fiber facilities or
3 purchasing special access *at above-cost prices* from SBC. Aside from the exclusionary effects of
4 special access contracts discussed above, AT&T explained that there are a number of reasons
5 why a CLEC may be forced to use RBOC facilities even if there is CLEC-owned fiber nearby.⁶⁸

- 6
7 (1) Connections to the fiber facility can only be made at a limited number of "Network
8 Access Points" that have been established for this purpose, places where terminating
9 equipment and cross-connection facilities are in place. There is a direct analogy to a
10 superhighway or mass transit system – even if you live right next to the highway or the
11 transit line, you can only access it at interchanges (in the case of the highway) or
12 stations (in the case of the transit line).
13
14 (2) The costs of effecting such a connection are often substantial, and can only be justified
15 where revenues at the particular customer location will be sufficient.
16
17 (3) Building owners are not obligated in many areas, as a legal matter, to allow CLECs to
18 bring facilities into their buildings, and where they do permit such entry may impose
19 construction, rental or other fees that will serve only to increase the entry barrier overall.
20
21 (4) Depending upon where the demarcation has been established, the BOC may own the
22 riser facilities within the building, whose use by a CLEC may potentially involve
23 makeready and recurring charges.

67. (...continued)
preparing these maps, it is also possible that for at least some of these locations the purported
CLEC fiber does not actually exist, it may exist but not be "lit," it may belong to a different
CLEC than the one serving the specific customer, or it may have been placed and engineered for
some use other than for "last mile" local service, such as for interoffice transport or as an
interexchange carrier access facility.

68. *See, generally, Fea/Giovannucci Declaration*, at paras. 39-49.

1 Given these complications, and given that much of the “CLEC owned” fiber cited by SBC in
2 these maps doubtless belongs to AT&T, the capability of CLECs to build their own “facilities-
3 based” last mile facilities will sink even further.

4
5 **SBC’s ability to set its switched and special access prices at excessive, supracompetitive**
6 **levels will significantly enhance its position and opportunities in the retail enterprise**
7 **services market if, following the merger, AT&T is no longer required to “pay” SBC for**
8 **access services.**
9

10 48. SBC has been able to set its DS-1/DS-3 special access prices at supracompetitive levels
11 as a result of the near-total dependence of virtually all IXC and CLECs on these facilities in
12 order to serve enterprise customers. These supracompetitive prices are much higher than the
13 corresponding UNE prices for the same elements, which are based upon forward looking per-unit
14 average costs and many multiples above the competitors’ prices for the same services where
15 available, because competitors’ prices are based upon economic cost. As a result of Commission
16 restrictions on the use of UNEs for so-called “mixed” (i.e. local and long distance traffic), and
17 “available facilities” limitations on UNE-provisioning requirements, IXCs and others are unable
18 to purchase these facilities at competitive rates.⁶⁹ In its most recent (end of year 2004) ARMIS
19 43-04 Report, SBC data indicate that the company generated a 76.19% rate of return on its
20 interstate special access services, up from 63.16% for the previous year. In fact, SBC’s rate of
21 return on special access has been growing steadily, *as has its special access revenue*:
22

69. See, e.g. *TRRO*, at paras. 34-40, and 64.

1 49. SBC and its sister RBOCs have sought to dismiss the extraordinary special access rates
2 of return as reported in ARMIS by challenging the validity of their own ARMIS data, claiming
3 that it may not be credibly used for ratemaking purposes.⁷⁰ Those arguments are without merit:
4

5 (1) The ARMIS financial results for SBC are derived from accounting data compiled by SBC
6 itself, presumably in accordance with the Commission's rules. SBC and the other RBOCs
7 themselves have had a major role in the development of these rules. SBC has relied upon
8 such accounting results as a basis for *increasing* rates (where the costs as reported in ARMIS
9 exceeded the revenues, as in the case of UNE rates), and should not be allowed to cherry-
10 pick its way through its financial data, treating it as gospel where it suits SBC's purposes,
11 while characterizing it as fantasy when it cuts against SBC's interests.
12

13 SBC and its sister RBOCs regularly rely upon ARMIS and laud its validity in other contexts.

14 While SBC challenges the use of ARMIS results when these show *excessive* earnings (as in

70. See, e.g., *AT&T Corp. Petition for Rulemaking To Reform Regulation of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services*, RM Docket No. 10593, *Opposition of SBC Communications*, December 2, 2002, at pp. 19-22; *Opposition of Verizon*, December 2, 2002, at pp. 21-23.

1 the case of special access), ARMIS takes on the role of the definitive authority when
2 ARMIS results suggest an earnings deficiency or “below cost” pricing.⁷¹ To explain away

71. For example, in May 2003 in Federal District Court in Chicago, Illinois, just five months after having challenged the use of ARMIS data for evaluating the reasonableness of special access prices in FCC RM-10593, SBC relied specifically upon ARMIS results to support its contention that UNE rates were not covering their costs. According to SBC's expert witness:

SBC Illinois' average revenue per loop (for UNE-L) and revenue per line (for UNE-P) per month is substantially below the costs that SBC Illinois recognizes on its books to provide those UNEs. I used the FCC's financial accounting information as reported in its Automated Reporting Management Information System ("ARMIS") files to obtain the historical cost data specifically for SBC Illinois. These data are reported to the FCC for purposes of tracking the interstate rate of return and are subject to a highly detailed set of reporting guidelines.

See, Affidavit of Debra J. Aron on behalf of SBC in United States District Court for the Northern District of Illinois, Eastern Division, Case No. 03-C3290, filed May 27, 2003.

Several months later, in December 2003, SBC was joined by USTA and other BOCs in lauding ARMIS as the source for the “actual” costs of UNEs in the response to the FCC’s *TELRIC NPRM*. See, e.g., *Review of the Commission’s Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, *Opening Comments of SBC Communications, Exhibit A, “The Economics of UNE Pricing,” Debra J. Aron, PhD and William Rogerson, PhD*, December 16, 2003, pp. 28-32.

SBC, now back to focusing upon special access, just one month later in January 2004 argued in US Court of Appeals for the District of Columbia Circuit (in opposing AT&T's *Petition for Writ of Mandamus*, see fn. 107, *infra*) that “ARMIS data ‘contain arbitrary allocations that are ‘economically irrational.’” *In re AT&T Corp. et al.*, No. 03-1397 (D.C. Cir.), *Response of Intervenor in Opposition to AT&T’s Petition for a Writ of Mandamus*, filed January 9, 2004, at 13.

However, in testimony filed shortly thereafter in Illinois, SBC’s expert, Dr. Debra Aron, once again defended the validity of ARMIS as the correct basis for benchmarking UNE costs:

In the final analysis, ARMIS is no better or worse than any cost accounting system for a
(continued...)

1 excessive profit levels for special access, SBC has claimed that in ARMIS, costs associated
2 with special access are being misallocated away from special access and over to the
3 Common Line category. However, when challenging the use of forward-looking costs for
4 pricing UNE-Loops, SBC staunchly defended the use of ARMIS Common Line data,
5 characterizing these accounting costs as the “actual costs” of providing UNEs. At least one
6 of these two patently conflicting claims must be false. The Commission cannot ignore
7 ARMIS earnings data on the basis of irreconcilable and patently self-serving claims that
8 ARMIS is, on the one hand, reliable for determining the “actual cost” of a single
9 disaggregated service element but entirely unreliable for calculating the aggregate (and
10 excessive) rate of return for the entire special access category.

11
12 (2) In any event, whether or not ARMIS data includes minor cost misallocations at the margins
13 does not affect the overall integrity of *trends* in the data, *since those claimed misallocations*
14 *do not change from period to period*. As Figure 2 and Table 2 demonstrate, SBC’s rate of

71. (...continued)

large, multiproduct firm. It is subject to strict reporting requirements and a consistent set of rules across carriers. Virtually all cost accounting systems will be subject to the criticism that they make allocations, and to the criticism that any full cost estimate (which, as I noted, includes TELRIC-based UNE prices as well) will reflect such allocations. However, the fact nevertheless remains that accounting systems are the basis for decision making in our economy, and that it is reasonable to look at accounting estimates of costs for benchmarking purposes such as this one.

Ill. C. C., Docket No. 02-0864, SBC Illinois Ex. 2.2 (Surrebuttal testimony of Dr. Debra J. Aron) filed March 5, 2004, at p. 9.

1 return on interstate special access has escalated from 39.55% in 1999 to an astounding
2 76.19% for 2004, while its interstate special access *revenues* also grew at double-digit year-
3 over-year rates, from \$2.5-billion in 1999 to \$4.5-billion in 2004. So even if the absolute
4 rate of return developed for the special access category using ARMIS data is off by some (at
5 most a very small) percentage, the trend in the data (escalating returns coupled with
6 escalating revenues) provides compelling evidence that SBC has the ability to increase
7 prices to supracompetitive levels without fear of attracting competitive entry or of losing so
8 much demand as to make the price increase unprofitable.

- 1 These returns – and the fact that they are increasing year-over-year at the same time that
2 aggregate special access demand is also experiencing double-digit growth – are not consistent
3

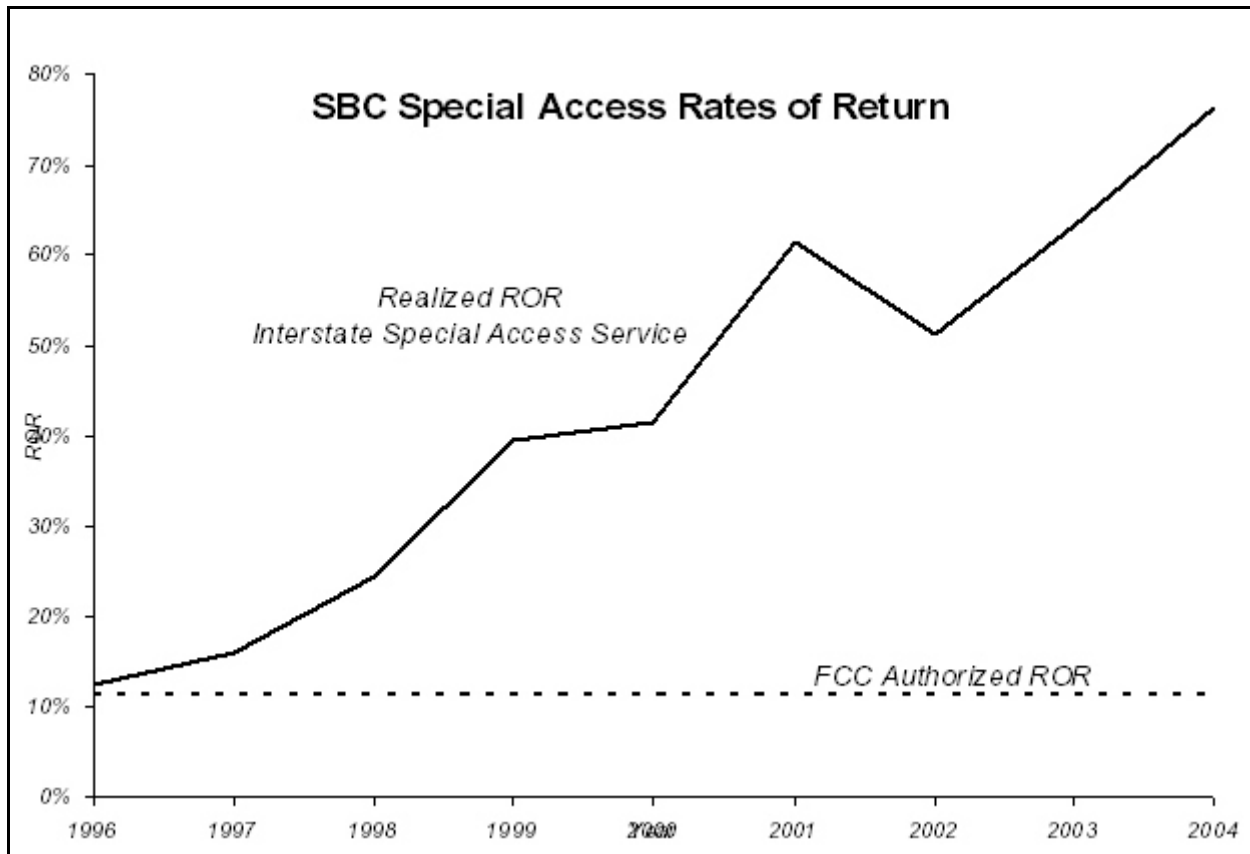


Figure 2. SBC Realized Rate of Return on Interstate Special Access, 1996-2004.

with anything that could realistically be expected to result in a competitive market, and all of the anecdotal evidence that SBC and its sister RBOCs may conjure up cannot change this fact.⁷²

Table 2		
SBC Interstate Special Access Revenues and Rates of Return		
Year	Special Access Revenues (\$billions)	Special Access ROR
1999	\$2.48	39.55%
2000	3.41	41.37%
2001	4.37	61.53%
2002	4.35	51.34%
2003	4.43	63.16%
2004	4.50	76.19%
Source: Federal Communications Commission, ARMIS Report 43-04, Access Report, YE 1999-2004. Available at http://www.fcc.gov/wcb/eafs (accessed April 25, 2005). Column O (Special Access) Row 8041 (Net Return) divided by Row 8040 (Average Net Investment).		

50. SBC's excessive special access prices will significantly enhance its position and opportunities in the retail enterprise services market, especially if SBC is permitted to merge with AT&T. In the TRR proceeding, AT&T introduced extensive evidence that the combined effect

72. Some have suggested that such high rates of return on special access should help to stimulate entry and result in more, not less, competition overall. That proposition requires that such entry be economically feasible and that the costs that a competitor might confront would be similar to those of an RBOC such as SBC. In fact, competitive carriers have been exiting the market for such facilities at an accelerating rate, despite the continued escalation of SBC profit levels. The *only* realistic conclusion that would be consistent with these facts is that the Bells have been able to foreclose business from competitors and thereby raise the minimum viable scale for entry.

1 of the excessive SBC special access prices and SBC's retail prices with which AT&T and other
2 CLECs must compete subjects SBC's rivals to a formidable price squeeze. AT&T for one,
3 claims to have ceased offering several local business services in light of the special access prices
4 that SBC and the other RBOCs charge.⁷³ AT&T has also shown that for many other services
5 such as private line service and Frame Relay, the RBOCs have set special access and retail prices
6 at levels that do not allow AT&T or any other efficient carrier to compete for many customer
7 segments on a going-forward basis.⁷⁴

8
9 51. A significant portion of what little competition actually exists in the special access
10 market – competition that is limited mostly to the OCn segment – comes from AT&T and MCI
11 themselves. For example, in their so-called *UNE Fact Report* submitted to the FCC in October
12 2004 by SBC and its sister RBOCs, a total of 31,669 “Buildings Connected Directly to CLEC's
13 Fiber Network Using CLEC Fiber” were identified, *out of which 6,400* – i.e., about 20% of the

73. AT&T first announced on June 23, 2004 that it was exiting the residential local and long-distance markets in seven states across the country (see AT&T News Release, “AT&T to Stop Competing in the Residential Local and Long-Distance Market in Seven States,” June 23, 2004, available at <http://www.att.com/news/item/0,1847,13121,00.html>, accessed May 6, 2005). The following month, AT&T went on to announce that it was ceasing all investment in traditional consumer services (see AT&T News Release, “AT&T Announces Second-Quarter 2004 Earnings, Company to Stop Investing in Traditional Consumer Services; Concentrate Efforts on Business Markets,” July 22, 2004 available at <http://www.att.com/news/item/0,1847,13163,00.html>, accessed May 6, 2005).

74. *TRR Proceeding*, WC Docket 04-313, Declaration of Alan G. Benway, Robert G. Holleron, Jeffrey King, Michael E. Leshner, Michael C. Mullan, and Maureen Swift on behalf of AT&T Corp., October 4, 2004 (“*Benway et al Declaration*”).

1 total – were *attributed to AT&T*.⁷⁵ The *UNE Fact Report* (while it fails to enumerate the number
2 of MCI “directly-connected” buildings) contends that MCI provides last-mile facilities at all
3 levels, as well as wholesale access. Absorption of AT&T facilities that are within the SBC
4 region into the SBC network, and absorption of MCI facilities within the Verizon region into
5 Verizon will further reduce even the limited amount of competition that exists in the high
6 capacity facilities market.

7
8 52. AT&T submitted evidence in support of its *Special Access Petition*, in the *Triennial*
9 *Review* proceedings, and in the *Non-Dominant Proceeding* to demonstrate the extreme
10 competitive disadvantages that AT&T and other carriers confront as a consequence of their
11 dependence upon the RBOCs for essential services, including both UNEs and switched and
12 special access. Those disadvantages will disappear for AT&T by the time that the ink is dry on
13 the merger closing documents – at least within the SBC region – but will persist and worsen for
14 whatever few non-ILEC-affiliated CLECs and IXC remain.

75. RBOC *UNE Fact Report 2004*, at III-4, Table 1.

1 **Contrary to one of the key asserted benefits of the merger, the Commission was already**
2 **supposed to have enabled SBC to provide integrated service at parity with competitors by**
3 **eliminating Section 272 restrictions on SBC's ability to engage in joint operation,**
4 **installation and maintenance ("OI&M") activities for its ILEC and long distance entities.**
5

6 53. As discussed above, one of the key benefits that SBC and AT&T now claim for the
7 proposed merger is the ability to achieve scale and scope economies via integration of local and
8 long-distance network functions. But this contention is undercut by SBC's past advocacy,
9 arguing for forbearance from enforcing the Section 272(b)(1) requirement for separation of the
10 BOC and affiliate "operation, installation and maintenance" ("OI&M") functions because that
11 requirement caused difficulties and diseconomies in providing integrated services to enterprise
12 customers.⁷⁶ SBC advised the Commission that it was being disadvantaged by the inability to,
13 among other things, perform end-to-end testing as well as incurring certain additional costs for
14 duplication of functions, and that these concerns would be eliminated if the OI&M separation
15 requirements were eliminated. In its *OI&M Order* issued March 17, 2004, the Commission
16 accepted SBC's contentions and removed the OI&M separation requirements.⁷⁷ Although SBC

76. *Petition of SBC for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Sections 53.203(a)(2) and 53.203(a)(3) of the Commission's Rules and Modification of Operating, Installation, and Maintenance Conditions Contained in the SBC/Ameritech Merger Order*, CC Docket No. 96-149, 98-141(OI&M Proceeding), Petition For Forbearance and Modification, filed June 5, 2003 (SBC OI&M Petition).

77. *Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*, WC Docket No. 03-228, *Petition of SBC for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions under Sections 53.203(a)(2) and 53.203(a)(3) of the Commission's Rules and Modification of Operation, Installation, and*
(continued...)

1 had represented, in its *OI&M Petition*, that the requested forbearance would be sufficient to
2 address its concern, it now claims that the issue has not been resolved and proposes a far more
3 draconian “solution” – merger with AT&T.

4
5 54. Specifically, SBC’s claim here in the Joint Applicants’ filing is eerily similar to claims
6 it had made in its *Petition for OI&M Forbearance*:

7
8 SBC’s principal competitors thus may serve their customers using a single set of
9 engineers, technicians, support staff, customer service representatives, and systems,
10 which SBC, because of these OI&M provisions, and in order to avoid tariffing
11 requirements reserved only for dominant carriers, must operate with added costs that not
12 only inflate the prices it must charge to consumers, but also significantly complicate its
13 efforts to provide the high level of service quality that customers expect and deserve.⁷⁸
14

15 SBC’s claim in its *OI&M Forbearance Petition* was that this problem could be solved by
16 integrated network management – there was no mention of any need to merge with the largest
17 IXC in the country. Indeed, SBC cited examples where end-to-end testing over facilities owned
18 by *different carriers* provided high levels of “seamless service.”

77. (...continued)

Maintenance Conditions Contained in the SBC/Ameritech Merger Order, CC Docket Nos. 960149, 98-141, *Petition of BellSouth for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2)-(3) of the Commission’s Rules*, CC Docket No. 96-149, *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, *Report and Order* in WC Docket No. 03-228, *Memorandum Opinion and Order* in CC Docket Nos. 96-149, 98-141, 01-337, March 17, 2004 (*OI&M Order*).

78. SBC *OI&M Petition*, at 8.

1 [U]nder the current structure, even with respect to customer locations where SBC's
2 competitors use some ILEC facilities and not just their own facilities, SBC's BOCs are
3 able to work with the competitors to test circuits and help provide the competitors'
4 customers with seamless service. Yet, SBC cannot provide this same level of service
5 for its *own* operations on behalf of their *own* customers.⁷⁹
6

7 Thus, according to SBC, forbearance from enforcement of the OI&M requirements would place
8 SBC *at parity* with the level of service competitors could provide over those facilities. Since the
9 *OI&M Forbearance Order*, the Commission has acknowledged (in its TRRO) that a substantial
10 number of customer locations served by competitive carriers are provided over ILEC facilities,
11 and that CLECs requiring DS-1 and DS-3 dedicated access would, for the most part, be impaired
12 without access to UNEs.⁸⁰
13

14 55. In fact, nowhere in its *OI&M Forbearance Petition* does SBC cite a need for joint
15 *ownership* of facilities as being required for "seamless" service, end-to-end testing, or network
16 accountability – only joint operation, installation and maintenance of *separate* facilities. To the
17 contrary, SBC goes to great lengths to note that, if the Commission were to remove the OI&M
18 restriction, SBC would be able to fully compete with AT&T, WorldCom and Sprint:

19
20 The time has come for the Commission to recognize the OI&M restrictions for what
21 they are today – an artificial and unnecessary handicap on SBC's ability to serve
22 customers, which diminishes service quality and raises prices for SBC's customers,
23 which restraining SBC's ability to compete fully and thereby drive up quality and drive

79. *Id.*, at 18-19.

80. *TRRO*, at para. 146.

1 down prices for all customers. The OI&M restrictions do nothing in return to advance
2 the public interest, only the private interests of AT&T, WorldCom and Sprint.⁸¹
3

4 Yet here, SBC's Mr. Kahan would seem to be suggesting that the OI&M forbearance that SBC
5 had sought *and had obtained* is not sufficient, and that SBC actually needs to *own* AT&T in
6 order to compete in those market that up to now AT&T has dominated.
7

8 56. The extraordinary parallels between SBC's *OI&M Forbearance* story and the arguments
9 it has put forward here in support of the merger with AT&T cannot be overemphasized. In his
10 Declaration accompanying SBC's *OI&M Forbearance Petition*, Mr. Richard Dietz, President-
11 CEO of SBC Data Service, Inc. testified that several customers had cited SBC's "lack of an
12 integrated network management system as the basis for rejecting SBC's bid."⁸² An integrated
13 network management system would be one of the results, according to SBC, of OI&M
14 forbearance.⁸³ But now recall Mr. Kahan's similar lament in his Declaration here: "Large

81. *Petition of SBC for Forbearance From the Prohibition of Sharing Operating Installation and Maintenance Functions Under Sections 53.203(a)(2) and 53.203(a)(3) of the Commission's Rules and Modification of Operating, Installation and Maintenance Conditions Contained in the SBC/Ameritech Merger Order*, CC Docket No. 96-149, CC Docket No. 98-141, Reply Comments in Support of Petition for Forbearance and Modification, filed July 15, 2003, at 4.

82. SBC *OI&M Forbearance Petition*, Declaration of Richard Dietz, at fn. 2.

83. SBC *OI&M Forbearance Petition*, at 20-21.

1 business customers ... are often hesitant to award SBC major contracts because it [SBC] cannot
2 guarantee its ability to manage and control the networks over which the service is provided.”⁸⁴

3
4 57. Responding to SBC’s (and other RBOCs’) contentions *and rejecting AT&T’s*
5 *opposition*, the FCC did in fact remove the OI&M separation requirements in its *OI&M Order*,
6 released about one year ago.⁸⁵ There, the Commission found that its *Order* should “allow them
7 [the RBOCs] to compete more effectively with their rivals in the interLATA market, particularly
8 for customers desiring highly-customized service bundles such as large enterprise customers,
9 because they will have increased opportunities to obtain convenient, competitively priced
10 interLATA services.”⁸⁶ Put simply, in the *OI&M Order*, SBC got exactly what it said it needed
11 to achieve “seamless” end-to-end testing and provisioning of services. SBC can now compete
12 *in-region* on exactly the same basis as a non-affiliated carrier, and can compete out-of-region at
13 parity with the incumbent LEC there. Apparently that is not enough for SBC, since its story *du*
14 *jour* is now that *acquisition*, not *interconnection*, is what it will take for SBC to compete. And of
15 course, if SBC is correct, then no other non-ILEC rival has any possibility of successfully
16 competing with SBC. In its *OI&M Petition*, SBC blamed its (then) inability to compete with
17 AT&T on the OI&M restriction. So the Commission lifted the OI&M restriction, yet SBC still

84. *Kahan Declaration*, at para. 25.

85. See, generally, *OI&M Order*.

86. *Id.*, at para. 30.

pleads its inability to compete with AT&T. Ironically, if the merger is ultimately allowed, SBC still won't be competing with AT&T, because AT&T will no longer exist.

The merger exacerbates the already tenuous competitive situation created by the sunset of Section 272.

58. An SBC/AT&T merger, if combined with "sunset" of Section 272 on schedule, would substantially heighten the merged company's ability and incentives to engage in cost misallocation, which would facilitate overpricing local services to cross-subsidize retail long-distance services, to the detriment of competition and consumers. Although the Commission, in its *OI&M Order*, agreed to remove the restrictions preventing the RBOCs from integrating BOC and affiliate OI&M functions, the Commission nevertheless declined to remove the Sec. 272(b)(1) restriction on joint ownership of facilities that would have permitted the BOC and affiliates to collaborate on the purchase of equipment used by both entities. In its *Comments* in the OI&M docket addressing the joint ownership issue, AT&T itself provided substantial analysis of the serious risks of cost misallocation if the BOCs and their Section 272 affiliates were allowed to jointly own network facilities:

[I]f the BOCs were permitted to integrate their operations by jointly owning switches, transmission and associated land and buildings, a massive and far larger pool of joint and common costs would be created that would have to be allocated through inherently arbitrary allocations. As the Commission concluded in 1996, "the costs of wired telephony networks and network premises are largely fixed and largely shared among local, access, and other services," and thus sharing of these network facilities among the BOC and its § 272 affiliates would dramatically increase the magnitude of joint and common costs and thereby provide a "significant opportunity for improper allocation of

costs” that would impede long-distance competition and harm ratepayers. *Non-Accounting Safeguards Order* ¶ 159. ... at a minimum, the Commission can adopt more “effective regulation” by determining the “areas where the potential for anticompetitive behavior and misallocation of cost is great[est].” *Id.* ¶ 238. And, traditionally, the Commission has always found that the operation of the network and the “joint use of physical space” are the areas that present the most dangerous potential for cost misallocation. *Id.* ¶¶ 238, 240; see also *Non-Accounting Safeguards Order* ¶¶ 158-63; *Second Non-Accounting Safeguards Reconsideration Order* ¶ 50. It correctly determined that the harms to competition resulting from such integration clearly and inherently outweighed any efficiency gains that consumers would receive.⁸⁷

In the *OI&M Order*, the Commission accepted this reasoning, and maintained its policy of requiring that facilities used to provide competitive and noncompetitive services be separately owned. The Commission noted:

The joint facilities ownership restriction was adopted concurrently with the OI&M sharing prohibition to implement the “operate independently” requirement of section 272(b)(1). The joint facilities ownership restriction, codified in section 53.203(a)(1) of the Commission’s rules, provides that “[a] section 272 affiliate and the BOC of which it is an affiliate shall not jointly own transmission and switching facilities or the land and buildings where those facilities are located.” In adopting this restriction, the commission believed that joint ownership of facilities could facilitate cost misallocation and discrimination. Based on the record presented in this proceeding, we continue to believe that, unlike the OI&M sharing prohibition, the costs of maintaining separate ownership of facilities do not outweigh the benefits the rule provides against cost misallocation and discrimination. For example, based on the record, we are persuaded that shared facilities would likely create significant joint and common costs that would be inherently difficult to allocate properly.⁸⁸

87. *OI&M Proceeding*, Comments of AT&T Corp. filed December 10, 2003, at 17.

88. *OI&M Order*, at para. 32.

1 59. The formidable competitive advantages that SBC/AT&T will gain from integrated
2 facilities cannot be overstated. SBC's control of vast local facilities crucial to the provision of
3 many enterprise services will afford SBC substantial opportunities to discriminate against
4 competitors and engage in anticompetitive conduct if it is able to own and operate the facilities
5 on AT&T's network on an integrated basis. Section 272 of the *1996 Act* requires the RBOCs
6 initially to operate their long distance services out of a separate affiliate that transacts business
7 with the BOC ILECs on an "arm's length" basis. The initial idea of the OI&M restriction, the
8 joint ownership restriction, and the other safeguards of Section 272 was to mitigate the RBOCs'
9 bottleneck advantages, in hopes of allowing CLECs to acquire a base of customers and resources
10 sufficient to allow them to neutralize the RBOCs' bottleneck control of essential facilities.

11
12 60. Sec. 272(f)(1) provides that the separate affiliate requirement is to sunset three years
13 following the RBOC's receipt of Section 271 in-region long distance entry in a given state, but
14 may be extended by the Commission by rule or order. Thus far, the Commission has declined to
15 order any such extension, and has allowed the safeguards of Section 272 to sunset on schedule in
16 all instances in which the three-year period has elapsed. The Commission has not, however,
17 provided any explanation or justification for its determination not to extend the separate affiliate
18 requirement beyond the sunset date. As noted by (then) Commissioner Martin, "[m]any parties,
19 including state commissions, contend that it is premature to lift the separate affiliate safeguards

1 provided by section 272. For example, some contend that the sufficiency of the biennial audit
2 process has yet to be established.”⁸⁹

3
4 61. Since the purpose of the separate affiliate requirement was to protect the adjacent long
5 distance market from RBOC dominance until such time as sufficient local competition had
6 emerged, the only reasonable explanation for the Commission’s decision not to extend the
7 requirement beyond the three-year sunset date was its belief that sufficient local competition has
8 in fact developed and that the structural separation was no longer necessary as the means to
9 constrain the RBOCs’ exercise of market power or other incumbency advantages. But sufficient
10 local competition has not developed, and whatever the Commission’s reasons may have been, the
11 proposed mergers render any possible rationalizations meaningless. The two largest local service
12 competitors – AT&T and MCI – have agreed to be acquired by the two largest RBOCs. As such,
13 the *basis* upon which Sec. 272 was allowed to sunset no longer applies. If the two largest
14 CLECs do not believe that they can survive without becoming part of the two largest RBOCs, the
15 notion that the local market has been “irreversibly opened to competition” cannot withstand
16 scrutiny.

17
18 62. The mergers, when combined with the sunset of Section 272, will have a serious adverse
19 impact upon the *sustainability* of competition. The timing of the sunsets with the dates at which

89. *Section 272(f)(1) Sunset of the BOC Separate Affiliated and Related Requirements*, WC Docket 02-112, *Memorandum Opinion and Order*, Concurring Statement of Commissioner Kevin J. Martin, December 23, 2002.

1 the approval process for the SBC/AT&T and Verizon/MCI mergers may be completed may mean
2 that at virtually the *exact same time* that SBC and Verizon acquire control of their largest local
3 and long distance competitors, they will no longer be subject to any competitive safeguards with
4 respect to the joint operation of their local and long distance businesses.⁹⁰ As AT&T itself has
5 long argued, and as the Commission agreed in the *OI&M Order*,⁹¹ the use of integrated facilities
6 for regulated local and competitive long distance services raise significant competitive concerns.
7 As AT&T put it in its (unsuccessful) Petition urging the FCC to extend SBC's Section 272
8 obligations in Texas:

9
10 So long as SWBT enjoys substantial local market power, it will have the ability to act
11 on its clear incentives to discriminate and cross-subsidize in favor of its long distance
12 operations. This is not mere speculation. As confirmed by the biennial section 272
13 audit of SWBT's Texas operations, SWBT and its sister-BOCs have engaged in
14 substantial discrimination and cross-subsidization notwithstanding the limits and

90. Absent a change in Commission policy with respect to the sunset, the separate affiliate requirement will no longer exist in any SBC state by October 2006, just months after the merger, if approved, would likely be consummated, SBC received Section 271 Authority in the last of its states (Illinois, Indiana, Ohio and Wisconsin) in October 2003. Assuming the Commission continues to allow Section 272 to sunset after three years, Section 272 restrictions will sunset in these states in October of 2006. Even Though SBC is already permitted to integrate its long distance operations into its BOC operations in Texas and its four other Southwestern Bell states, it continues to operate them separately, pending resolution of whether and how a non-separated RBOC long distance operation will be regulated once the long distance and local operations were fully integrated (i.e., following the Sec. 272(f)(1)sunset).

91. *OI&M Order*, at para. 32.

1 transparency imposed by the section 272 safeguards. If no such safeguards were in
2 place, this anticompetitive conduct would only escalate.⁹²
3

4 The proposed mergers create a fundamental change in the conduct of the RBOCs' long distance
5 operations. Whereas today both SBC and Verizon provide retail long distance service by
6 purchasing capacity from long distance wholesalers and reselling it to their local service
7 customers, the post-merger SBC will presumably seek to operate its own (the former AT&T)
8 long-haul facilities on an integrated basis with the BOCs' operations, and to self-provide long
9 distance service over the AT&T network. This self-provisioning would necessitate a heretofore
10 unseen level of service and facility integration. As a purchaser of wholesale service from
11 WilTel, SBC has paid WilTel for capacity on its network, for which WilTel assumes
12 responsibility for the OI&M functions associated with its network. This wholesale arrangement
13 effectively limited the opportunities for SBC to engage in anticompetitive conduct and cost
14 shifting by significantly limiting the number of services and facilities provided by the SBC BOC
15 and needed by SBC Long Distance to provide service.
16

17 63. These practical limitations of the RBOCs' provisioning of long distance service through
18 wholesale facilities have existed for each RBOC providing long distance service during all
19 periods covered under currently available Section 272 Biennial Audits. However, none of the

92. *Extension of Section 272 Obligations of Southwestern Bell Telephone Co. in the State of Texas*, WC Docket No. 02-112, Petition of AT&T Corp., April 10, 2003, at 5-6. Although the Commission apparently disagreed with AT&T's argument at the time by allowing the sunset of Sec.272 to occur on schedule in Texas, because no order addressing the sunset was ever issued, the actual Commission reasons for allowing Section 272 to sunset are unknown.

1 biennial audits completed thus far have included auditing of any significant amount of facilities-
2 based long distance services provided by an RBOC affiliate,⁹³ primarily because none of the
3 RBOCs that have completed biennial audits provide facilities-based long distance services in-
4 region. (SBC, Verizon and BellSouth provide in-region long distance entirely via resale of
5 wholesale services purchased from other carriers.) Despite this fact, the opportunities for cost-
6 shifting and discrimination from even the limited amount of joint facilities and services has
7 proven too much of a temptation for SBC. As described by AT&T, the Section 272 Audit in
8 Texas showed “not merely discriminatory but also deteriorating service quality”⁹⁴ with respect to
9 services provided by the SBC BOC to non-affiliates.

10
11 64. The combined effect of removing the Section 272 requirements from SBC at the same
12 time it acquires significant long distance facilities will make cost misallocation, cross-subsidiz-
13 ation, and discrimination virtually undetectable. Integrated operations such as those available to
14 the post-merger, post-sunset SBC will make it extremely difficult for state commissions and
15 other regulatory bodies to set rates and allocate costs. Even with the structural separation

93. SBC, Verizon and BellSouth all provide long distance service through resale. Qwest, as a result of accounting irregularities, provided long distance service through a resale Section 272 affiliate until November 3, 2003, and did not, at that time, merge its resale affiliate into its facilities-based affiliate. The most recently filed Qwest Section 272 biennial audits cover the period from January 2, 2003 through January 1, 2004. As a result, there is less than 2 months worth of audited data regarding a start-up facilities based Qwest Section 272 affiliate. See, *Qwest Communications International, Inc. Section 272 Biennial Audit*, EB Docket No. 03-198, Ernst & Young, Report of Independent Accountants on Applying Agreed-Upon Procedures, filed June 10, 2004, at 8.

94. *AT&T Texas Audit Comments*, at 19.

1 requirement in place, SBC is able to engage in cost shifting via joint marketing of local and long
2 distance services using BOC employees and other resources, and by furnishing various services
3 to both its BOC and long distance entities out of a separate “service company” that is able to
4 engage in *de facto* resource sharing for the benefit of both the BOC and long distance entities.

5 As noted by the Pennsylvania Public Utility Commission during the New York Sunset
6 proceeding:

7
8 The separate accounting requirement of section 272 is consistent with the PA PUC’s
9 interest in preserving their right to do an audit. Audits can produce useful information
10 for policymakers such as the PUC. With recent changes and reduction in FCC
11 accounting and reporting, the collapse of the affiliate into the incumbent local exchange
12 carrier perpetuates what appears to be a continual reduction in available information,
13 and, therefore, is not a preferred change. The PA PUC currently proscribes separate
14 accounting for operations related to ILEC, CLEC, IXC, and CAP. Maintaining this
15 separation will be difficult if the FCC allows the section 272 safeguards to collapse.
16 This separate accounting method assists the PA PUC in its ability to design rates for the
17 local exchange carrier segment, including the unbundled network elements. The ability
18 to readily identify costs and revenues from the business segment is critical to ongoing
19 rate review.⁹⁵
20

21 SBC and AT&T have presented the FCC with no details as to their plans regarding their intended
22 organization of AT&T assets within the combined post-merger entity. However, the merged
23 entity would emerge with *no regulatory oversight whatsoever* on its ownership of vast AT&T
24 and SBC facilities and its use of these facilities to provide combined local and long distance
25 services, making it almost impossible to detect and prevent cost misallocation, cross-

95. *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-122, Comments of the Pennsylvania Public Utility Commission, July 22, 2002, at 4-5.

1 subsidization and discrimination favoring the merged entity's competitive services at the expense
2 of customers of monopoly local and access services.

3
4 **Existing rules governing the allocation of ILEC costs as between "regulated" and**
5 **"nonregulated" services are incapable of addressing the massive integration of network**
6 **facilities and organizational resources that would result from the merger of SBC and**
7 **AT&T.**
8

9 65. A number of parties filing Comments and Petitions to Deny have raised serious
10 concerns regarding the potential for cross-subsidization of competitive services by SBC's
11 monopoly services, and discriminatory treatment favoring SBC's (or its affiliates') competitive
12 services vis-à-vis those furnished by nonaffiliated rivals.⁹⁶ Of course, such acts are expressly
13 prohibited by the Commission's rules and by statute,⁹⁷ but the detection of such conduct has
14 become increasingly difficult and the extent of after-the-fact enforcement has been largely
15 ineffective, if for no other reason than the fact that it takes so long for complaints of such
16 anticompetitive conduct to be resolved that extensive damage can be done to competition and to
17 specific competitors even if, in the end, the complaints are held to be valid.

18
19 66. But many of the existing regulatory mechanisms for detecting and preventing cross-
20 subsidization and discrimination were never designed to deal with a substantially deregulated

96. *Comments of Global Crossing North America, Inc.*, April 25, 2005; *Comments of ACN et al.*, at 34-45; *Comments of Cbeyond et al.*, at 10-16.

97. 47 U.S.C. § 254(k).

1 SBC/AT&T entity that would result from the proposed merger. As an example, nearly twenty
2 years ago the Commission had adopted 47 CFR §64.901 specifically to address and to foreclose
3 cross-subsidization of nonregulated services via cost misallocation. However, as recognized by
4 the Commission in the *OI&M Order*, 47 CFR §64.901(c)) does *not* prevent cost misallocation
5 and cross-subsidization in the case of jointly owned facilities.⁹⁸ Allocation of fixed plant as
6 between monopoly and competitive services is inherently arbitrary, and can be easily
7 manipulated, even within the context of 47 CFR §64.901(c)), to shift costs from the competitive
8 services to monopoly services.

9
10 67. Generally, 47 CFR §64.901 requires that the costs of jointly-used facilities be allocated
11 between competitive and monopoly services based upon *use*, and not upon cost causation. Thus,
12 the decision to purchase a particular asset may be driven exclusively by the goal of providing a
13 competitive service, but if the asset, once having been acquired, is then used to provide both
14 competitive and monopoly services, its costs would then be allocated strictly in proportion to
15 such use.

16
17 68. Consider the following example. Suppose that the existing copper loop distribution
18 plant is not capable of providing (competitive) video services (which is in fact the case). So the
19 RBOC embarks upon a massive capital spending program to entirely *replace* its copper plant
20 with fiber to the home. Once installed, the fiber will then be used to provide *both* conventional

98. See fn. 77, *supra*.

1 monopoly voice telephone service *and* competitive video service. Under the use-based
2 allocation requirement of 47 CFR §64.901, the cost of the jointly-used plant is to be assigned
3 based upon the highest use of the asset for each purpose over the coming three (3) year period.⁹⁹
4 If, during that period, only a small fraction of customers sign up for the BOC's video service, the
5 overwhelming majority of the costs of the fiber-to-the-home investment will be assigned to Plain
6 Old Telephone Service ("POTS"), *even though no portion of the capital investment was required*
7 *for POTS*. 47 CFR §64.901(c)) was adopted at a time when the extent of an ILEC's
8 nonregulated activities was expected to be relatively small. Indeed, even today, only a small
9 portion of the BOC's total costs are actually being classified as *nonregulated*. For example,
10 according to the latest (end-of-year 2004) SBC ARMIS reporting, only 1% of total SBC plant in
11 service and 12% of total SBC operating expenses are classified as "nonregulated." 47 CFR
12 §64.901(c)) is simply not up to the task of dealing with the infusion of massive amounts of
13 nonregulated plant and expenses, which is exactly what will occur if SBC and AT&T are
14 permitted to merge.

15
16 69. If the *effect* of ownership of joint facilities is to shift costs to regulated services and/or to
17 permit nonregulated services to use jointly-owned facilities without properly allocating costs

99. 47 CFR §64.901. The rule states, "The allocation of central office equipment and outside plant investment costs between regulated and nonregulated activities shall be based upon the relative regulated and nonregulated usage of the investment during the calendar year when nonregulated usage is greatest in comparison to regulated usage during the three calendar years beginning with the calendar year during which the investment usage forecast is filed."

(which the Commission noted would be extremely difficult¹⁰⁰), then the result is to create a cross-subsidy of SBC's competitive operations by its regulated monopoly services. And that is expressly and unambiguously prohibited in, although not foreclosed by, 47 CFR §64.901(c): "A telecommunications carrier may not use services that are not competitive to subsidize services subject to competition," notwithstanding the limitations of 47 CFR §64.901's ability actually to detect such conduct.

70. Similarly, the ownership of essential local inputs like high-capacity digital access facilities and collocation space by an *integrated* local/long distance enterprise provider such as the combined SBC/AT&T entity would produce significant risks of discrimination. The *Non-Accounting Safeguards Order* specifically cited the potential effect of joint ownership on discriminatory access to facilities:

Moreover, the ban on joint ownership of facilities should protect local exchange competitors that request physical collocation by ensuring that a BOC's section 272 affiliate does not obtain preferential access to the limited available space in the BOC's central office.¹⁰¹

100. See fn. 77, *supra*.

101. *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, *First Report and Order*, 11 FCC Rcd 21905(1996), 21983 (footnotes omitted).

1 As discussed earlier, the FCC recently found that competitors were impaired without access to
2 DS1 and DS3 facilities into customer premises at cost-based rates.¹⁰² SBC's proposal to own the
3 AT&T network and to provide these essential inputs *both* to itself *and* to its competitors will
4 specifically allow SBC preferential access to these and other competitively essential facilities.

5
6 **The unconstrained ability for a post-merger SBC/AT&T to engage in cross-subsidization,**
7 **together with its continued stranglehold on special access facilities, will result in predatory**
8 **pricing and force the exit of smaller competitors from the market.**
9

10 71. SBCs current position as the virtual monopoly provider of special access facilities
11 throughout its thirteen state region affords it the ability to extract virtually all of the potential
12 economic profit available for competitive provision of enterprise services. Even before the
13 merger, when AT&T was SBC's single largest *customer* for special access services and its single
14 largest *competitor* for end-user enterprise services, SBC managed to escalate its monopoly
15 special access prices to the point where, for the year ended December 31, 2004, it had achieved a
16 rate of return on interstate special access services of 76.19%. In fact, that figure likely
17 *understates* the actual extent of economic rent that SBC has been able to achieve, since it is
18 calculated on a *regulatory basis* using *embedded cost* data reported by SBC in the FCC's ARMIS
19 database. If expressed in terms of forward-looking economic cost, such as TELRIC, the realized
20 rate of return would almost certainly be considerably greater.

102. See fn. 10, *supra*.

1 72. Through its practice of shifting virtually all of its economic profit into the monopoly
2 special access services and away from the retail services that SBC offers to end-user enterprise
3 customers, SBC is able to maintain essentially the same aggregate earnings level whether or not
4 it, or a competitor, provides the end-user service. But by overpricing special access, SBC has
5 been able to impose a classic price squeeze upon competitors, making their retail offerings in the
6 enterprise segment unprofitable. This fact has been well documented by AT&T and others
7 before both the FCC and the Courts.¹⁰³ AT&T and MCI are the two largest providers of
8 enterprise services to national customers, and through years of experience and extensive
9 networks have acquired significant market share in the enterprise market. It is this enterprise
10 market share that SBC and Verizon covet, and it is this combination of enterprise market share
11 and special access monopoly that make the proposed mergers a sure-fire recipe for rapid
12 remonopolization of this segment. If SBC is able to obtain AT&T's *retail* market share and
13 combine that with its *wholesale* access monopoly, it will have the facilities, customer base,
14 incentive *and the opportunity* to discriminate against rivals and engage in predatory pricing on a
15 massive scale.

103. See fn. 62, *supra*.

1 **Predation and price squeezes between SBC's retail prices and its special access charges**
2 **are currently occurring, and have the potential to become even more aggressive vis-à-**
3 **vis other CLECs once AT&T has been absorbed into SBC.**
4

5 73. AT&T has presented detailed analyses of the RBOCs' ability to engage in a price
6 squeeze, notwithstanding the existence of price cap regulation. For example, in the TRR
7 proceeding, AT&T declarants Benway *et al.* explained:

8
9 [T]he special access rates paid by AT&T (which are among the lowest access rates
10 available) are typically well in excess of what the RBOC charges its own retail
11 customers. For example, as AT&T has already shown in prior filings, the access
12 component of RBOC retail offerings are substantially lower than AT&T's wholesale
13 special access rates. Thus, even if AT&T can offer the other parts of the service at a
14 cost equal to, or less than, what the RBOC incurs, this "spread" makes it impossible for
15 AT&T to profitably offer many services. Worse yet, Exhibits 1-5 herein show that even
16 the RBOCs' *total* retail price for these services is below what AT&T pays for special
17 access.¹⁰⁴

18
19 74. Up to now, the *only* practical constraint on SBC's special access rate escalations has
20 been AT&T's persistence in challenging SBC's practices at the Commission and in the federal
21 courts. In October, 2002, AT&T filed a formal petition¹⁰⁵ with the Commission in which AT&T
22 demonstrated that SBC and the other RBOCs have consistently increased special access prices in
23 the putatively competitive "pricing flexibility" MSAs to the point where rates in these areas were
24 consistently higher than those that remained subject to price caps in the non-pricing flexibility

104. Benway *et al. Declaration*, at para. 45.

105. See fn. 62, *supra*.

1 areas. AT&T argued that the Commission's pricing flexibility rules, adopted in its 1999 *Special*
2 *Access Pricing Flexibility Order*,¹⁰⁶ were, through the application of arbitrary "triggers" based
3 upon metrics such as the percentage of wire centers in which a specified number of CLECs had
4 established collocations, presuming the presence of sufficient competition to constrain RBOC
5 special access prices when, in fact, such competition simply did not exist. By November, 2003,
6 the Commission had taken no action in response to AT&T's *Petition*, prompting AT&T to seek a
7 *Writ of Mandamus* from the D. C. Circuit.¹⁰⁷ Oral arguments were held On October 21, 2004, at
8 which time the Commission assured the Court of Appeals that it was in the process of drafting a
9 Notice of Proposed Rulemaking addressing special access pricing flexibility and other related
10 issues. Relying upon such assurances, the Court deferred issuance of the *Writ* and, on January
11 31, 2005, the Commission did in fact release the long-awaited NPRM, which was not published
12 in the *Federal Register* until April 18, 2005. AT&T strongly opposed granting pricing flexibility
13 for special access based upon the proposed triggers, appealed the Commission's order, initiated
14 the *Special Access Petition*, sought the *Writ of Mandamus*, and challenged specific special access
15 rate filings.¹⁰⁸ Even with all of that multi-year effort, the Commission has still failed to address

106. *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 98-63, 98-157, *Fifth Report and Order and Further Notice of Proposed Rulemaking*, 14 FCC Rcd 14221(1999), aff'd *WorldCom v. FCC*, 238 F.3d 449 (D.C. Cir. 2001).

107. AT&T Corp., et al., D.C. Circuit Case No. 03-1397, *Petition for Writ of Mandamus*, filed November 6, 2003.

108. *Access Charge Reform*, CC Docket No. 96-262, AT&T Reply Comments on LEC Pricing Flexibility FNPRM, filed November 29, 1999, Motion of AT&T Corp. For Stay of Pricing Flexibility Order Pending Judicial Review, filed November 21, 2000. See also, *Special*
(continued...)

1 the issued raised. With AT&T out of the picture as an advocate on special access pricing issues,
2 the prospect of further FCC action becomes even more uncertain. To the extent that SBC may
3 have held back on even more aggressive price increases in the face of the pending litigation,
4 without the prospect of an AT&T challenge, SBC would be free to impose substantially higher
5 rate levels as soon as the merger is closed.¹⁰⁹

6
7 75. Raising special access rates to levels that make competition unprofitable will enable
8 SBC/AT&T to force smaller competitors out of the market altogether. Moreover, the
9 demonstrated ability of SBC to impose different prices for the same essential services to different
10 customers, as discussed by several commentators including Global Crossing and CompTel/ALTS,
11 would enable SBC to be selective in its competition foreclosure efforts. Where such competitors
12 rely upon any kind of SBC access service or facility as in essential input to that carrier's end-user
13 service offering, SBC will be able to significantly undercut that competitor's retail price –
14 especially when it can exact a higher charge from the competitor than from its own affiliate for

108. (...continued)

Access Petition and Petition for Writ of Mandamus; SBC Communications Inc. Petitions for Pricing Flexibility for Special Access and Dedicated Transport Services for Ameritech Operating Companies, Nevada Bell, Pacific Bell Telephone Company, Southern New England Telephone Company, and Southwestern Bell Telephone Company, WCB/Pricing No. 03-8, Comments of AT&T Corp., filed February 14, 2003.

109. Despite its whopping 76.19% rate of return on special access, SBC's rates are not as high as those imposed by other RBOCs, affording SBC considerable "headroom" in raising rates while staying under the highest rates already in effect in other locations. Once an RBOC has satisfied the "triggers" established in the Commission's special access pricing flexibility rules in any given MSA, it is subject to no constraints as to how high it can raise special access rates.

1 the same service or facility.¹¹⁰ Through targeted predatory pricing, SBC/AT&T will be able to
2 make certain customers or products or geographic markets unprofitable for rival firms.

3
4 **The SBC/AT&T and Verizon/MCI mergers will result in *de facto* geographic market**
5 **allocation as between the two mega-carriers, leaving each to largely remonopolize the**
6 **enterprise market within its BOC operating footprint.**
7

8 76. SBC's Mr. Kahan has *conceded* that SBC has been unable to profitably serve enterprise
9 customers whose principal service requirements fall outside of the SBC BOC footprint.¹¹¹
10 AT&T declarants Benway *et al* have indicated that AT&T confronts similar profitability
11 conditions where it is required to purchase special access from an RBOC.¹¹² Neither SBC nor
12 AT&T offer any explanation or suggestion as to how their merger will alter this condition *except*
13 *where the service is being furnished within the SBC BOC footprint and AT&T is, as a practical*

110. CompTel/ALTS refers to SBC's "271 Local Switching Transport Offering" – SBC's replacement for the Sec. 251 UNE-Switching element that it is no longer required to provide – and its volume-based pricing structure that affords the largest CLECs (who can commit to purchase in excess of 750,000 switch ports from SBC) a discount of more than 50% per switch port and a 90% discount on usage charges relative to the charges applicable to CLECs committing to take less than 450,000 ports. CompTel/ALTS notes that no cost justification has been offered by SBC for this enormous volume-based price spread, and also expresses the view that the *only* CLEC that may qualify for the maximum discounts is AT&T, SBC's soon-to-be affiliate. In fact, on its face, SBC's discounts could not possibly have a cost basis. A CLEC ordering 449,999 switch ports at \$26 each would pay a total of \$11,699,974 per month, whereas a larger CLEC (e.g., AT&T) ordering 750,001 switch ports at \$12 each would pay only \$9,000,012, i.e., about 23% *less* for about 50% *more* service.

111. *Kahan Declaration*, at paras. 23-28.

112. See fn. 104, *supra*.

1 *matter, relieved of the requirement to “pay” SBC for special access at SBC’s supracompetitive*
2 *prices.* Put differently, but accepting Mr. Kahan’s “sweet spot” explanation for SBC’s focus on
3 in-region enterprise customers, the merger will afford SBC/AT&T a formidable – perhaps
4 *insurmountable* – competitive advantage in serving both SBC and AT&T enterprise customers
5 within the SBC region, but will do little or nothing to improve the *out-of-region* situation for
6 SBC or AT&T.

7
8 77. In fact, when considered together with the pending Verizon/MCI merger, the result of
9 both mergers will almost certainly be a *de facto* geographic market allocation of enterprise
10 customers as between post-merger SBC and post-merger Verizon. For the very same reason that
11 SBC has found it unprofitable to compete for enterprise customers outside of its thirteen sates,
12 Verizon has undoubtedly encountered precisely the same conditions in attempting to expand
13 beyond its legacy Bell Atlantic/NYNEX and GTE ILEC serving areas. After its merger with
14 MCI, Verizon/MCI would enjoy precisely the same type of special access competitive advantage
15 within the Verizon “sweet spot” that SBC/AT&T will achieve within the SBC “sweet spot.”
16 Verizon/MCI will not be required to pay cash money for (the equivalent of) special access within
17 the Verizon operating areas, but will be forced to make such payments for special access outside
18 of its region. Verizon/MCI will have the same type of economic incentive to concentrate its
19 efforts in the Verizon region as SBC/AT&T will have for concentrating its efforts in the SBC
20 region. At the same time, the persistence of supracompetitive special access prices will operate

1 to keep other competitors – including CLECs and the other two RBOCs (i.e., BellSouth and
2 Qwest) – out of both the SBC and the Verizon states.

3
4 78. In fact, MCI has already expressed publicly its recognition of this considerable access
5 charge advantage. In a March 29, 2005 press release explaining its rejection of Qwest's revised
6 \$26 per share offer for the acquisition of MCI, MCI gave as one of its considerations for
7 accepting the lower-valued Verizon offer the superior "access economics" that would be
8 available to MCI by joining with Verizon.¹¹³ Verizon serves some 53.0-million switched access
9 lines, 21.6-million of which are in the Northeast, whereas Qwest serves only 13.4-million
10 switched access lines spread across fourteen western states.¹¹⁴

11
12 79. *Cbeyond et al.* suggest that the RBOCs have up to now operated under at least a tacit
13 agreement not to compete with one another, and that such an outcome is even more likely in an
14 industry dominated by two giant, yet roughly equal sized firms.¹¹⁵ While I certainly do not
15 disagree with Dr. Wilkie's analysis – one that is amply supported by observed RBOC conduct
16 over the past twenty-one years – I would note that for the reasons that I have previously
17 discussed *and from Mr. Kahan's own explanations*, geographic market allocation is the most

113. MCI Press Release, *MCI Accepts Revised Proposal From Verizon*, March 29, 2005.

114. ARMIS Report 43-08, Switched Access Lines in Service, 2004, accessed May 6, 2005.
"Northeast" is considered Connecticut, Maine, Massachusetts, New Hampshire, New Jersey,
New York, Rhode Island, Vermont.

115. *Comments of Cbeyond et al.*, at 41-54.

1 likely outcome of the combined SBC/AT&T and Verizon/MCI mergers even in the absence of a
2 deliberate policy on the part of each firm to stay out of the other's territory.

3
4 80. Moreover, various types of reciprocal accommodations as between post-merger SBC
5 and post-merger Verizon are also a likely outcome, whose effect would be to exclude all smaller
6 rivals – including BellSouth and Qwest – from competing within the greater SBC/Verizon
7 footprint. Qwest likely appreciates this, which may well explain its frenzied pursuit of MCI.
8 Such reciprocal arrangements can be easily accomplished through the use of volume-based
9 discounts for essential facilities, such as the SBC “271 Switching Transport Offering” identified
10 by CompTel/ALTS and the type of special access pricing device described by Prof. Farrell. With
11 SBC and Verizon together controlling the only two national interexchange carriers with
12 significant presence in the national enterprise customer market, tacit conduct that works to
13 preserve and to allocate the enterprise market between the two of them and to exclude all others
14 is certainly an entirely plausible outcome.

15
16 81. As long as special access charges remain at their present heights and create the kind of
17 economic barrier that, according to SBC's Mr. Kahan, has made SBC's attempt to compete out-
18 of-region unprofitable, the net result of the two mega-mergers will be to make SBC/AT&T the *de*
19 *facto* monopoly provider of enterprise services in the SBC states and to make Verizon/MCI the
20 *de facto* monopoly provider of enterprise services in the Verizon footprint. Competitors –
21 including the other two RBOCs – will certainly confront even greater barriers to entry within

1 these fortress monopoly areas than those that SBC has confronted when attempting to compete
2 out of region.

3
4 **If SBC was ever serious about becoming a national competitor in the enterprise market, it**
5 **should have been supporting, not opposing, the availability of UNEs and special access**
6 **services at cost-based rates and with service standards fully comparable to those that each**
7 **RBOC provides for itself.**
8

9 82. SBC claims that by acquiring AT&T it will be able to provide service to large enterprise
10 customers nationwide. Yet, as I have discussed at considerable length, a merged SBC/AT&T
11 entity will encounter the same costs and difficulties competing out-of-region that SBC confronts
12 today, without AT&T. As a non-incumbent carrier outside of its core thirteen states, SBC's
13 interests and concerns should be *identical* to those of any other CLEC or IXC with respect to the
14 pricing and availability of essential services and access to the *incumbent* LECs' networks. SBC
15 would want to be able to obtain UNE-P arrangements at cost-based rates. SBC would want to be
16 able to obtain DS-1 and DS-3 distribution and interoffice UNEs at cost-based rates, and to be
17 able to utilize these without any use-based restrictions. SBC would want cost-based special
18 access and switched access rates. In short, SBC would want – and need – to confront essentially
19 the same economic conditions with respect to ILEC access whether in-region or out-of-region.
20 In fact, the *only* reason why SBC does *not* want these things is because it has concluded that it
21 would be more profitable for it to exploit its in-region local service monopoly than to expand its
22 geographic scope in Verizon and other RBOC/ILEC areas.

83. If the two RBOCs' claims as to their intentions of becoming national competitors in the enterprise market are legitimate, they should each be *embracing*, and certainly not *opposing*, changes to their access offerings that could be implemented regardless of the status of generic industry-wide regulatory proceedings. Moreover, the problems with SBC's and Verizon's excessive and discriminatory special and switched access charges would be compounded by the proposed mergers, which is why both should be disallowed. In all events, however, the companies should be required to take the following actions:

- SBC and Verizon should reduce their switched access and special access price levels to forward-looking economic cost (with no "local" vs. "long distance" distinctions, consistent with the notion of an "all distance" market), in order to ensure that all competing carriers, including both SBC and Verizon outside of their respective regions, will confront the same economic cost levels whether using their own in-region access facilities or purchasing access services from SBC or Verizon.
- Moreover, to protect competition, both ILECs should not be permitted to take advantage of special access "pricing flexibility," and should be required to stop enforcing "use restrictions" and restrictions on combining and commingling UNEs and special access services. Regardless of whether such restrictions are permitted under Section 251 and the Commission's generic rules, they would have a particularly negative impact upon competition in the context of the proposed mergers.

1 • To counteract the incentives and opportunities to impose “price squeezes,” SBC and Verizon
2 should be subject to strict enforcement of all federal and state imputation requirements, in
3 accordance with the imputation rules proposed by AT&T in the *Non-Dominant Proceeding*,
4 WC Docket No. 02-112, which is annexed hereto as Attachment 2.

5
6 **Even if the various access pricing concerns can be resolved, measures will need to be**
7 **adopted to assure that the two mega-carriers do not discriminate against rivals in the**
8 **provision of essential services and facilities.**
9

10 84. The imposition of excessive and discriminatory access prices is by no means the only
11 manner in which a post-merger SBC/AT&T or Verizon/MCI can effectively frustrate entry by
12 other carriers – including each other or other RBOCs – into their respective regions. Through
13 their monopoly control of essential bottleneck facilities, the two mega-carriers will be in a
14 position to deny, delay, or degrade essential services required by their rivals – including each
15 other.

16
17 85. In evidence introduced in the TRR proceeding, AT&T has explained and provided
18 evidence of SBC’s incentive and ability to degrade services furnished to rivals, AT&T in this
19 instance:

20
21 The RBOCs also have every incentive to discriminate between their own retail
22 customers and AT&T, by providing patently inferior quality special access than to
23 which it provides itself. Quite obviously, this gives the RBOCs a major advantage
24 when competing for retail enterprise business. Just as those retail customers prefer low
25 prices, they also prefer high quality service. If AT&T cannot match the RBOCs’

1 service quality, it is at an enormous competitive disadvantage, particularly for “mission
2 critical” services needed by many enterprise customers. ... As AT&T and other carriers
3 have detailed in the Commission’s pending Special Access Performance Measure
4 Proceeding (CC Docket No. 01-321), firm order confirmations are often not provided on
5 a timely basis, installation commitments are missed and the mean time to repair or
6 restore problem or trouble circuits to normal operating levels are lengthy and often
7 compromise customer service. ... AT&T has supported these claims with hard data
8 showing the poor (and in many cases, declining) service quality provided by the
9 RBOCs. ... AT&T has also produced hard evidence showing that the RBOCs provide
10 competitive carriers substantially worse performance than they provide their own retail
11 affiliates.¹¹⁶
12

13 To the extent that all major full service carriers have experienced the same degradation of quality
14 and pricing issues that AT&T describes in its numerous filings, enterprise customers had little or
15 no *ability* to leave AT&T for SBC or for another RBOC. Indeed, as noted by Mr. Kahan, SBC
16 itself would not have provided service to many of these customers anyway, where more than
17 49% of their service demand was outside the SBC region (i.e., where SBC could not guarantee
18 that another RBOC would not degrade their service quality). Even after the merger, SBC will be
19 unable to offer such a guarantee beyond its thirteen states, and others seeking to offer service
20 within the SBC states will confront corresponding difficulties in dealing with SBC.
21

22 86. As long as SBC/AT&T are presented with economic incentives to deny, delay or
23 degrade essential services requested by rival carriers, no regulatory conditions on the
24 SBC/AT&T merger would prevent the ultimate destruction of smaller carriers in the enterprise
25 segment. Indeed, if Mr. Kahan’s characterizations of enterprise customer *perceptions* regarding

116. *Benway et al. Declaration*, at paras. 46, 48.

1 out-of-region services are correct, then SBC/AT&T will not even need to discriminate in the
2 service they provide to competitors if they create the *perception* on the part of enterprise
3 customers that by virtue of SBC's ownership of bottleneck facilities only SBC has the *ability* to
4 provide an acceptable quality of service. For enterprise customers with mission-critical service
5 requirements, the mere *possibility* of a combined SBC/AT&T discriminating against rivals in its
6 provision of bottleneck services would be sufficient to cause enterprise customers to reject
7 providers other than SBC/AT&T.

8
9 **SBC's claims of intermodal competition rely upon services that are not yet mature or**
10 **viable alternatives to wireline service, and/or that are themselves also provided by SBC or**
11 **that involve the use of SBC bottleneck facilities.**
12

13 87. SBC's *Public Interest Statement* posits that wireless services, e-mail, and VoIP (Voice-
14 over-Internet Protocol) all need to be considered in assessing the market share and universe of
15 "potential" competition. Although some amount of limited substitution among these services is
16 clearly present, overall the demand for wireline services remains highly inelastic.

17 88. Several recent cases have addressed the issue of intraLATA toll elasticity. A
18 quantitative measure of the extent to which wireline long distance services confront intermodal
19 competition is the *own price elasticity* of wireline long distance call demand, an issue that the
20 Commission has grappled with in the past.¹¹⁷ In at least two recent state PUC cases addressing

117. See, e.g., *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, *Second Report and Order*, FCC 90-314, para. 83 and 84 and Appendix C, released October 4, 1990.

1 rate reductions for BOC intraLATA toll services, the BOC offered highly inelastic price
2 elasticity estimates, and challenged the less-price-inelastic estimates that were advanced by the
3 commission staffs and by intervenors.¹¹⁸ In fact, AT&T had itself recently presented evidence
4 from these cases before this Commission in the *BOC Non-Dominant* proceeding, WC Docket
5 No. 02-112.¹¹⁹

6
7 *Wireless*
8

9 89. SBC claims that competition from wireless will serve as a check on its wireline long
10 distance prices. As the FCC noted in its recent *Wireless Competition Survey*, wireless is not yet a
11 full substitute for wireline service. Specifically, the Commission cited studies where consumers
12 had indicated a high level of specific quality of service problems with wireless calls:

13
14 GAO also estimated that “about 47% of adult mobile phone users believed their call
15 quality was improving, while about 5 percent believed that their call quality was getting
16 worse.” GAO also reported that “[d]espite the many mobile phone customers who
17 appeared to be satisfied with their overall call quality, a number of survey respondents
18 reported that they were experiencing specific problems.” For example, “about one-third
19 of customers could not complete 10 percent or more of their calls because they were in a
20 cell where the carrier did not provide service.” About 12 percent reported that such a

118. Price elasticity can be defined as the percent change in quantity resulting from a 1% change in price. Since, for most “normal” goods and services, the price/quantity relationship is *inverse* (i.e., when price goes up, quantity demanded goes down, and vice versa), price elasticity is generally expressed with a minus sign. Thus, if the price elasticity is, say, -0.4 , then for each 1% drop in price, quantity would be expected to increase by 0.40%, all else being equal.

119. *Non-Dominant Proceeding*, Reply Comments of Lee L. Selwyn on Behalf of AT&T, at paras. 41-42.

1 problem occurred at least one-third of the time. In addition, just over 20 percent of
2 respondents reported problems “getting a call through because [of a] fast busy signal or
3 a message that says the call failed” or problems “with a call being cut off or dropped” at
4 least 10 percent of the time. When examining consumer opinions, it is important to
5 keep in mind that consumer perceptions of service quality can change independently of
6 actual changes in network performance, as consumers’ expectations evolve.¹²⁰
7

8 Wireless call quality is not yet up to the level of wireline service and, indeed, it is likely that
9 customers do not expect such a level of service quality precisely because they do not yet expect
10 wireless to be a true substitute for wireline service. Moreover, for the same reasons described
11 earlier, SBC and Verizon will control a substantial share of their wireless customers in each’s
12 region, and will not use their wireless assets to compete with their wireline monopolies any more
13 than they will use their wireline assets to compete with each other.
14

15 *VoIP/Data Platforms*
16

17 90. SBC particularly cites the coming age of VoIP as a check to both its local and long
18 distance market power. However, in the vast majority of cases, consumer use of these services is
19 completely dependent upon ILEC bottleneck services (and therefore ILEC bottleneck pricing).
20 In most cases, neither SBC or Verizon offer so-called “naked” DSL, i.e., DSL without
21 subscription to a local telephone exchange service access line. Thus, ILEC DSL pricing policies
22 effectively stymie the substitution of VoIP services for ILEC local services. Additionally, VoIP

120. *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993 Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, WT Docket No. 02-379, *Eighth Report*, Rel. July 14, 2003, at para. 88.

1 has numerous technical difficulties. As noted by Deutsche Bank, “the threat from VoIP has been
2 a little bit overblown and we certainly do not see a step-change in industry dynamics – at least
3 for the next five years.”¹²¹

4
5 91. Moreover, as CompTel/ALTS and Broadwing/Saavis explain, the post-merger Internet
6 backbone market will be a duopoly nationwide with regional monopolies. Thus, competitive
7 VoIP providers will face another choke point in the heretofore competitive backbone input in
8 addition to the monopoly access to the customer input.

9
10 **The absorption of AT&T into SBC and of MCI into Verizon provides compelling evidence**
11 **of the ultimate effectiveness of the SBC and Verizon predatory pricing tactics.**
12

13 92. “Predatory pricing” is a form of economic warfare in which a well-heeled seller
14 deliberately sets its prices below cost so as to drive rivals out of the market, with the goal of
15 recovering the shortfall through excessive prices that become possible once all rivals have been
16 eliminated. The type of price squeeze described above is a form of predatory pricing, and is one
17 that the RBOCs have been pursuing at least since their reentry into the long distance market.

18
19 93. For a number of years, however, the RBOCs have been denying their involvement in
20 such practices, arguing that predatory pricing could never work in an open market. For example,

121. Deutsche Bank Industry Update, *Wireline - Mid Year Review*, May 27, 2003, at 67.

SBC declarant Dennis W. Carlton, testifying for SBC in the *Non-Dominant Proceeding*, has claimed that:

The foremost reason [that predation is not a concern] is that it is widely recognized that predation is rarely a profitable strategy. As noted above, firms that engage in predation incur some short-run losses in order to obtain longer-term gains. In order for predation to be successful, it is essential that attempts by the surviving firm to raise price (after driving its rivals from the market) do not result in entry. If entry occurs, firms will not be able to sustain the increase in price necessary to make predation a profitable strategy. It is highly unlikely that a predatory strategy would succeed in the long distance industry. First, the industry includes several large, well-established rivals which include both wireline long distance carriers and wireless service providers. In addition, much industry investment consists of fixed assets, such as copper plant, fiber optic plant, switches and other equipment. These assets are likely to remain available to a new entrant, even if existing long distance companies are driven from the market. Thus, it would be difficult for a firm engaging in predation to prevent firms from entering the industry by purchasing these assets after the predator attempted to raise price in order to recoup its investment.¹²²

Of course, the “several large, well-established rivals” to which Prof. Carlton was referring were AT&T and MCI. AT&T and MCI are being eliminated from the market via acquisition by the two RBOCs rather than via bankruptcy, but the effect is the same. Moreover, and decidedly contrary to Prof. Carlton’s hypothesis, the AT&T and MCI assets will not “remain available to a new entrant,” but will instead be absorbed into SBC and Verizon, respectively. Prof. Carlton’s prediction that “it would be difficult for a firm engaging in predation to prevent firms from entering the industry by purchasing these assets after the predator attempted to raise price in order to recoup its investment” clearly does not ring true: By acquiring AT&T and MCI *along*

122. *Non-Dominant Proceeding*, Declaration of Dennis W. Carlton, Hal Sider and Allan Shampine, filed June 30, 2003 (*Carlton/Sider NonDom Declaration*), at paras. 54-55.

1 *with their network assets*, SBC and Verizon, respectively, will have succeeded in “prevent[ing]
2 firms from entering the industry” and, in so doing will “be able to sustain the increase in price
3 necessary to make predation a profitable strategy” for each of them. Contrary to Prof. Carlton’s
4 speculation, the two carriers – AT&T and MCI – have been very successfully forced to exit the
5 market by merging with the predatory firms. Through these mergers, the two exiting firms’
6 facilities, far from “remaining available to new entrants” are being purchased by the predatory
7 firms. Notably, the same Dennis W. Carlton is a declarant for the Joint Applicants in the instant
8 matter, where he opines that the proposed merger “is unlikely to create significant competitive
9 problems ...”¹²³ The Commission should take note of Prof. Carlton’s obviously less-than-
10 prescient assessment as to the ultimate outcome of SBC’s and Verizon’s attempts at predation in
11 evaluating the credibility of his present appraisal of the ultimate outcome and impact on
12 competition arising from the SBC/AT&T merger.

13
14 94. In fact, there is substantial economic literature contradictory to Prof. Carlton’s claims
15 that competitors will simply re-enter the market if a firm raises prices to recoup its predatory
16 investment. As has been explained by the Tenth Circuit Court of Appeals:

17
18 Recent scholarship has challenged the notion that predatory pricing schemes are
19 implausible and irrational. See, e.g., Patrick Bolton et al., *Predatory Pricing: Strategic*
20 *Theory and Legal Policy*, 88 Geo. L.J. 2239, 2241 (2000) (“Modern economic analysis
21 has developed coherent theories of predation that contravene earlier economic writing
22 claiming that predatory pricing conduct is irrational.”). Post-Chicago economists have
23 theorized that price predation is not only plausible, but profitable, especially in a

123. *Carlton & Sider Declaration*, at para. 5.

1 multi-market context where predation can occur in one market and recoupment can
2 occur rapidly in other markets. See Baker, *supra*, at 590.

3
4 Although this court approaches the matter with caution, we do not do so with the
5 incredulity that once prevailed.¹²⁴
6

7 AT&T has specifically accused RBOCs, including SBC, of engaging in predatory pricing. For
8 example, in my Declaration on behalf of AT&T in the *Non-Dominant* proceeding (WC Docket
9 No. 02-112), I provided a substantive analysis of the incentive for and the ability of an RBOC to
10 successfully engage in predatory pricing. This included statements by investment analysts that
11 the RBOCs were *already* engaging in this conduct.¹²⁵
12

13 95. If the SBC/AT&T merger is allowed to go forward concurrently with the Verizon/MCI
14 merger, each of the two firms will be able to engage in predatory pricing in its own in-region
15 service areas, and will also be able to block competition for enterprise services by other providers
16 throughout both the SBC and Verizon footprints, which together embrace 67% of total US
17 GDP.¹²⁶ The ultimate outcome of the two mergers will be the concentration of enterprise traffic

124. US v. AMR, ___ F.3d ___, 2003-3 Trade Cases ¶74,078 (10th Cir 2003), slip. op. at 10-11.

125. *Non-Dominant Proceeding*, Reply Declaration of Lee L. Selwyn, filed July 28, 2003, at paras. 68-69, citing Deutsche Bank Industry Update, Wireline - Mid Year Review, May 27, 2003 at 3, 52.

126. Figure is understated, as it includes only Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont, Virginia, West Virginia as Verizon states. Bureau of Economic Analysis, United States Department of

(continued...)

1 in the combined SBC/AT&T and Verizon/MCI entities, with little or no entry opportunities for
2 other carriers in the enterprise market.
3

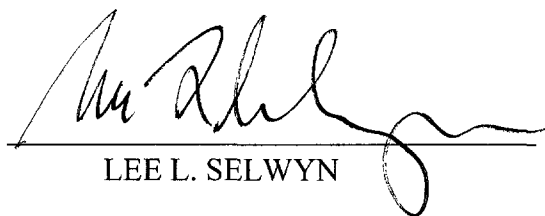
4 96. With the post-merger SBC/AT&T and Verizon/MCI each concentrating their efforts
5 within their respective “sweet spots,” little or no competition *between the two mega-firms is*
6 *likely to emerge*. Both have bottleneck control of facilities needed by the other out-of-region,
7 and once they had successfully dispatched smaller rivals, the two surviving giants would have no
8 incentive to compete with each other or to challenge each other’s own anticompetitive tactics.
9 The enterprise market would, in the end, be allocated among these two regional monopolies,
10 such that even the competition that now exists as between AT&T and MCI would cease.
11

12 97. The Commission has been confronted with claims as to the competitively beneficial
13 effects of each of the five prior RBOC mergers, *yet none of these gains have materialized*.
14 Competition is imploding, and the hyperbole about increased competition now being offered by
15 the various SBC/AT&T declarants must be viewed in the context of similar – and similarly
16 *wrong* – claims that have been offered to this Commission in the past.
17

126. (...continued)
Commerce, Gross State Product. Available at <http://www.bea.doc.gov/bea/regional/gsp/>
(accessed May 5, 2005.)

VERIFICATION

The foregoing statements are true and correct to the best of my knowledge, information and belief.



LEE L. SELWYN

Attachment 1
Statement of Qualifications
Dr. Lee L. Selwyn

Statement of Qualifications

LEE L. SELWYN

Dr. Lee L. Selwyn has been actively involved in the telecommunications field for more than thirty-five years, and is an internationally recognized authority on telecommunications regulation, economics and public policy. Dr. Selwyn founded the firm of Economics and Technology, Inc. in 1972, and has served as its President since that date. He received his Ph.D. degree from the Alfred P. Sloan School of Management at the Massachusetts Institute of Technology. He also holds a Master of Science degree in Industrial Management from MIT and a Bachelor of Arts degree with honors in Economics from Queens College of the City University of New York.

Dr. Selwyn has testified as an expert on rate design, service cost analysis, form of regulation, and other telecommunications policy issues in telecommunications regulatory proceedings before some forty state commissions, the Federal Communications Commission and the Canadian Radio-television and Telecommunications Commission, among others. He has appeared as a witness on behalf of commercial organizations, non-profit institutions, as well as local, state and federal government authorities responsible for telecommunications regulation and consumer advocacy.

He has served or is now serving as a consultant to numerous state utilities commissions including those in Arizona, Minnesota, Kansas, Kentucky, the District of Columbia, Connecticut, California, Delaware, Maine, Massachusetts, New Hampshire, Vermont, New Mexico, Wisconsin and Washington State, the Office of Telecommunications Policy (Executive Office of the President), the National Telecommunications and Information Administration, the Federal Communications Commission, the Canadian Radio-television and Telecommunications Commission, the United Kingdom Office of Telecommunications, and the Secretaria de Comunicaciones y Transportes of the Republic of Mexico. He has also served as an advisor on telecommunications regulatory matters to the International Communications Association and the Ad Hoc Telecommunications Users Committee, as well as to a number of major corporate telecommunications users, information services providers, paging and cellular carriers, and specialized access services carriers.

Dr. Selwyn has presented testimony as an invited witness before the U.S. House of Representatives Subcommittee on Telecommunications, Consumer Protection and Finance and before the U.S. Senate Judiciary Committee, on subjects dealing with restructuring and deregulation of portions of the telecommunications industry.

In 1970, he was awarded a Post-Doctoral Research Grant in Public Utility Economics under a program sponsored by the American Telephone and Telegraph Company, to conduct research on the economic effects of telephone rate structures upon the computer time sharing industry. This work was conducted at Harvard University's Program on Technology and Society, where he was appointed as a Research Associate. Dr. Selwyn was also a member of the faculty at the College of Business Administration at Boston University from 1968 until 1973, where he taught courses in economics, finance and management information systems.

Dr. Selwyn has been an invited speaker at numerous seminars and conferences on telecommunications regulation and policy, including meetings and workshops sponsored by the National Telecommunications and Information Administration, the National Association of Regulatory Utility Commissioners, the U.S. General Services Administration, the Institute of Public Utilities at Michigan State University, the National Regulatory Research Institute at Ohio State University, the Harvard University Program on Information Resources Policy, the Columbia University Institute for Tele-Information, the International Communications Association, the Telecommunications Association, the Western Conference of Public Service Commissioners, at the New England, Mid-America, Southern and Western regional PUC/PSC conferences, as well as at numerous conferences and workshops sponsored by individual regulatory agencies.

Dr. Selwyn has presented testimony in cases addressing each of the five previous RBOC mergers. He appeared on behalf of the California PUC's Office of Ratepayer Advocates in both the SBC/Pacific Telesis and the Bell Atlantic/GTE merger dockets. That work included, among other things, analyses of the effect of the mergers on competition and on the surviving firms' market power, ratepayer impacts, including the applicants' recovery of merger-related costs and the flow-through of merger benefits to California ratepayers, and the conformance of the mergers with applicable California Public Utility Code requirements. Dr. Selwyn was engaged in 1996 by the State of Maine Office of Public Advocate with respect to the NYNEX/Bell Atlantic merger, in 1998 by the State of Connecticut Office of Consumer Counsel to address the merger of the Southern New England Telephone Company ("SNET") into SBC, and in 1998-99 by the Illinois Attorney General to present testimony in the Illinois Commerce Commission's proceeding regarding the merger of SBC and Ameritech.

Dr. Selwyn has also participated in a number of matters addressing non-merger change of control and other affiliate transaction issues. He was engaged by the California PUC Office of Ratepayer Advocates in 1992-1993 with respect to the Pacific Telesis "spin-off" of its cellular and other wireless subsidiaries. In 2003, Dr. Selwyn testified for the Staff of the Washington State Utilities and Transportation Commission addressing financial and public interest issues arising from Qwest's sale of its directory publishing business ("DEX") to a group of private investors. Dr. Selwyn has also been involved in numerous other cases addressing intercarrier compensation, interconnection, access charges, imputation, competition, and market power issues, including a number of Section 271/272 proceedings, and the FCC's *Triennial Review* and *Triennial Review Remand* proceedings.

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LEE L. SELWYN

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Illinois Commerce Commission, *Illinois Bell Telephone Company Filing to Increase Unbundled Loop and Nonrecurring Rates*, ICC Docket No. 02-0864, on behalf of AT&T Communications of Illinois, Inc., Direct Testimony filed February 20, 2004, Rebuttal Testimony filed February 20, 2004.

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Arizona Corporation Commission, *Application of US West Communications for Ratemaking*, Docket No. T-1051B-99-0105, on behalf of AT&T Communications of the Mountain States, Inc., Direct Testimony filed August 8, 2000, Supplemental Testimony November 13, 2000.

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Texas Public Utilities Commission, *Proceedings to Examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of 1996*, Docket No. 21982, on behalf of AT&T Communications of Texas, L.P., TCG Dallas, and Teleport Communications Houston, Inc. Direct Testimony filed with Patricia D. Kravtin March 17, 2000, Rebuttal Testimony filed March 31, 2000.

Attachment 2
Imputation Rules proposed by AT&T
in the RBOC Non-Dominant Proceeding
WC Docket No. 02-112

EX PARTE OR LATE FILED

ORIGINAL



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REDACTED - FOR PUBLIC INSPECTION

June 9, 2004

RECEIVED

Ms. Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W., Room TWB-204
Washington, DC 20554

JUN - 9 2004

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: Ex parte, *Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112, CC Docket Nos. 00-175, 01-337, 02-33

Dear Ms. Dortch:

On Tuesday, June 8, 2004, Lee Selwyn, James Talbot and the undersigned, representing AT&T, met with William Dever, Michael Carowitz, William Kehoe, Jon Minkoff, William Cox, Kimberly Jackson, Alicia Dunnigan and Cliff Rand of the Wireline Competition Bureau concerning the above-captioned proceeding. We discussed the growth of BOC long distance market shares and the need for service specific imputation safeguards for BOC in-region long distance services, as described by the attached *Ex Parte* Declaration of Lee Selwyn, dated June 8, 2004, which was distributed at the meeting. We also distributed at the meeting a document that examines confidential BOC data filed pursuant to the Commission's Protective Order of December 22, 2003, and that is accordingly designated as Confidential and filed separately under seal. We also referred to the increases in BOC long distance subscribers and the forecast for U.S. broadband IP telephony subscribers shown by the attached excerpts from recent reports.

Respectfully submitted,

cc: M. Carowitz K. Jackson
W. Cox W. Kehoe
W. Dever J. Minkoff
A. Dunnigan C. Rand

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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the Matter of

Section 272(f)(1) Sunset of the
BOC Separate Affiliate and
Related Requirements

WC Docket No. 02-112

2000 Biennial Regulatory Review
Separate Affiliate Requirements of
Section 64.1903 of the Commission's
Rules

CC Docket No. 00-175

Ex Parte Declaration

of

LEE L. SELWYN

on behalf of

AT&T Corp.

June 8, 2004

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EX PARTE DECLARATION OF LEE L. SELWYN

1 Introduction and Summary

2
3 Lee L. Selwyn, of lawful age, declares and says as follows:

4
5 1. My name is Lee L. Selwyn; I am President of Economics and Technology, Inc. ("ETI"),
6 Two Center Plaza, Suite 400, Boston, Massachusetts 02108. I submitted a Declaration in this
7 matter on June 30, 2003, and a Reply Declaration on July 28, 2003, on behalf of AT&T Corp.
8 ("AT&T").

9
10 2. This *ex parte* declaration describes the service-by-service imputation requirements that
11 should be implemented to prevent cross-subsidization when BOCs provide in-region long

1 distance services on an integrated basis – irrespective of whether BOC-provided long distance is
2 regulated as dominant or nondominant. Sample text for an imputation and cost allocation rule
3 that is consistent with these requirements is provided in Appendix 1. My comments herein focus
4 upon two key aspects of an imputation requirement.

5
6 *First*, I explain why BOC integrated long distance services should be required to impute
7 BOC local service functionality and services at their *fair market value*. In an ideal world, all
8 access and tariff services required by nonaffiliated IXCs as inputs to their own long distance
9 offerings would be priced based upon forward looking economic cost, and all *non-tariff*
10 functionality and services that are being used by the BOCs when providing long distance
11 services on an integrated basis would be offered and available to nonaffiliated IXCs on a
12 nondiscriminatory basis *and* at rates based upon forward-looking economic cost. Since
13 none of these conditions apply, the use of a fair market value imputation standard will at
14 least assure that the BOCs derive no competitive advantages as a consequence of their
15 integrated provisioning of monopoly local and competitive long distance services that are
16 not also available to competing nonaffiliated carriers. BOCs are already required by section
17 272(e)(3) (which does not sunset along with other provisions of section 272) to comply with
18 a market value imputation standard with respect to access services (where “fair market
19 value” is, for this purpose, defined as the tariff rate). The same imputation standard should
20 also be applied to non-access tariff services and to any non-tariff BOC local service
21 functionality and services that are used by BOCs in providing long distance services on an
22 integrated basis. Anticompetitive cross-subsidization of integrated BOC long distance

1 services can be prevented only if those services are required to impute BOC local service
2 functionality and services at fair market value.

3
4 *Second*, I explain why adequate safeguards to prevent cross-subsidization require imputation
5 to be satisfied on *service by service* basis, and I outline the changes in the Commission's
6 Part 64 and cost allocation rules and other changes that are necessary to achieve this result.

7
8 *Finally*, I emphasize that dominant carrier regulation is also required of BOC long distance
9 services provided on an integrated basis, to ensure that BOC long distance prices are fully
10 supported by all imputed and actual costs.

11
12 **Integration of BOC in-region long distance operations with BOC ILEC entities requires**
13 **improved imputation safeguards supported by dominant carrier regulation.**
14

15 3. In an ideal world, rival firms in competitive markets should have equal and equivalent
16 access to all of the principal inputs to the production of their respective products and services; if
17 one such firm happens to wield monopoly control over one or more of these essential inputs, it
18 would have the ability to limit entry and competition in its downstream product market.
19 Sections 251 and 252 of the *Telecommunications Act of 1996* ("1996 Act") and the FCC's
20 implementation thereof seek to address this condition, specifically with respect to *local* telecom-
21 munications services, by requiring that CLECs be afforded nondiscriminatory access to ILEC
22 network resources at prices based upon forward-looking economic cost. In the case of *long*
23 *distance* services, if all tariff services required by nonaffiliated IXCs as inputs to their own long

1 distance offerings were priced based upon forward looking economic cost, and if all *non-tariff*
2 functionality and services that are being used by the BOCs when providing long distance
3 services on an integrated basis were also being offered and available to nonaffiliated IXC's on a
4 nondiscriminatory basis *and* at prices based upon forward looking economic cost, the BOCs'
5 opportunity and ability to engage in anticompetitive conduct would be severely constrained.
6 However, none of these conditions apply in the real world. As such, the use of a fair market
7 value imputation standard – codified at sections 272(b)(5), 272(c), and 272(e)(3) and as reflected
8 in the Commission's affiliate transaction rules (47 CFR §32.27) – were all aimed at assuring that
9 the BOCs derived no competitive advantages as a consequence of their partially integrated
10 provisioning of monopoly local and competitive long distance services that were not also
11 available to competing nonaffiliated carriers.

12
13 4. However, once the BOCs fully integrate their local and long distance services, Secs.
14 272(b)(5) and 272(c) will no longer apply. As a result, the costs associated with providing (the
15 now integrated) interLATA services will become more difficult to isolate and to quantify, and
16 thus become more prone to abuse. Moreover, if BOC-provided interLATA services are
17 classified as *non-dominant* such that the BOCs will not be required to file tariffs once the
18 separate interLATA affiliates are eliminated, there will be no proactive mechanism, other than
19 through an after-the-fact audit, to assure that the prices being charged for (the integrated)
20 interLATA services adequately compensate the BOC for the costs it incurs in producing them.
21 Although the Commission has decided to allow the Section 272 separate affiliate requirement to

1 sunset even though the BOC retains market power in the local market,¹ nothing in that decision
2 entails surrendering the Commission's authority to implement and to enforce stringent safe-
3 guards pertaining to the assignment of direct costs, the allocation of joint costs, and the sharing
4 of common overhead costs, as between local and long distance services.

5
6 5. If a BOC's access charges to competing IXC's are significantly greater than the economic
7 cost of comparable access functions that the BOC realizes *itself*, the BOC would have the ability
8 to impose a price squeeze upon its nonaffiliated rivals by setting its retail end user prices at
9 levels sufficient only to recover its own economic costs, while forcing competing providers to
10 incur considerably higher out-of-pocket access charges. Imputation of both tariff access charges
11 that an IXC would pay, and imputation of the costs that an IXC would incur to acquire (on a
12 stand-alone, i.e., non-integrated basis) any non-tariff services being provided by the BOC for the
13 benefit of its (affiliated or integrated) long distance business, can mitigate the potential for such
14 price squeezes *but only to the extent that the imputation requirement is properly specified and*
15 *effectively enforced.*

16
1. *AT&T Petition for Extension Of Section 272 Obligations Of Southwestern Bell Telephone Co. In The States Of Kansas and Oklahoma*, WC Docket No. 02-112, at 7-8 (Dec. 8, 2003) (SWBT market share in Oklahoma was 89% and in Kansas 83% at the end of 2002, and SBC told investors that in the second and third quarters of 2003 it had significantly *reversed* its access line losses); *AT&T Petition for Extension Of Section 272 Obligations Of Verizon In The State Of Massachusetts*, WC Docket No. 02-112, at 7-8 (Feb. 19, 2004) (Verizon market share in Massachusetts was 81% as of the end of June, 2003 and Verizon, in its January 29, 2004 investor briefing, reported that in the most recent two quarters it has *reversed* the rate of UNE-P net additions).

1 6. The BOCs contend that integrated operation enables them to produce local and long
2 distance services at a lower combined cost than would prevail under Sec. 272 structural
3 separation.² The imposition of strict imputation and cost allocation requirements would not
4 require that any of these economies of scope be sacrificed, but would help to assure that those
5 gains from integration are properly allocated and inure to both segments of their (integrated)
6 operations in a manner that does not afford an undue or unique competitive advantage to the
7 (competitive) long distance business. The entirety of all potential efficiencies would be realized,
8 but such gains would be apportioned in a fair and competitively neutral manner. Conversely,
9 conferring such integration benefits to the long distance business in a disproportionately and/or
10 discriminatory manner would constitute a cross-subsidization of long distance by local.

11
12 7. The best – and economically efficient – means for addressing this problem would be to
13 require that access charges and the prices of any non-tariffed services being provided to the
14 BOC’s long distance business unit (whether separated or integrated) be made available to non-
15 affiliated carriers at prices set at forward-looking economic cost. IXC’s would then confront the
16 same costs for any tariff or non-tariff services they purchased from a BOC as the BOC itself
17 would confront. If the BOC elected to, in effect, “piggy-back” its long distance services onto its
18 core local services by imposing upon the former only the additional costs (over and above the
19 core services baseline), it would be required to offer those same “piggy-back” prices to non-

2. See, e.g., *Section 272(b)(1)’s “Operate Independently” Requirements for Section 272 Affiliates*, WC Docket 03-228, Comments of the Verizon Telephone and Long Distance Companies; Comments of SBC, Comments of BellSouth, filed December 10, 2003.

1 affiliated carriers. If access rates and any non-tariff LEC services used to provide BOC long
2 distance services were made available to non-affiliated carriers at prices set at forward looking
3 economic cost, cross-subsidization would be present only where the actual or effective intra-
4 corporate transfer price did not cover forward looking economic cost – or where no transfer price
5 was even being charged at all. This is sometimes referred to as the “ratepayer indifference”
6 standard – i.e., as long as the customers of core monopoly services are made no worse off by the
7 existence of the transfer, no cross-subsidization is present.

8
9 8. Where, as in the present circumstance, prices being charged to nonaffiliated carriers for
10 access and for non-tariff services such as billing and collection are set well in excess of forward
11 looking economic cost– and where some BOC functionality, such as joint marketing, is not even
12 available to nonaffiliated firms – a more comprehensive definition of “cross-subsidization”
13 becomes necessary. Generally, “cross-subsidization” occurs when telecommunications services
14 that are not subject to regulation by the Commission are priced below cost *either* (a) by using
15 revenues or profits being derived from services that are subject to the Commission’s jurisdiction
16 or that of another regulatory agency, or (b) by affording the deregulated or nonregulated services
17 access to assets, resources, facilities and functions of the integrated, regulated firm without
18 bearing a fair share of their costs, or when a provider's deregulated services derive benefits from
19 the regulated operations without the regulated operations receiving just and reasonable compen-
20 sation from the deregulated operations for the benefits derived. The Commission should adopt
21 this definition of cross-subsidization and should implement a cost allocation and imputation

standard that ensures that long distance prices reflect the fair value of the functionality provided from the BOC.³

Section 272 (e)(3) already sets the proper imputation standard for access.

9. Where the BOC operates its in-region long distance business out of a separate affiliate, the 1996 Act imposes two specific sets of requirements aimed precisely at achieving the outcome described above – imputation of the full value of services undertaken on behalf of long distance operations. Although the RBOC Sec. 272(a) long distance subsidiaries were envisioned as being structurally separated from the BOC ILEC entities, they have nevertheless been permitted to make extensive use of their affiliated BOCs’ tariffed and non-tariffed services.⁴ Section 272(e)(3) requires that the full access charges be imputed into and used to establish a price floor for the BOC’s long distance services. For other (non-access) tariff services, as well as for many (but not all) non-tariff services, Sec. 272(c) requires the BOC to make these

3. The full value of services undertaken by a BOC on behalf of its long distance operations should correspondingly be imputed as a revenue to be credited against the cost of providing the BOC’s regulated monopoly local exchange and access services.

4. See, e.g. affiliate agreements posted at:
<http://www.verizonld.com/regnotices/index.cfm?OrgID=1>;
http://bellsouthcorp.com/policy/transactions/?PROACTIVE_ID=cececececec6cecacfc5cecfcfcf5cececbc9c7c9cbc6c6c6c5cf;
<http://www.qwest.com/about/policy/docs/QwestLD/overview.html>; <http://www.sbc.com/gen/public-affairs?pid=3078>

1 available to non-affiliated firms on the same basis as they are offered to its affiliate, and Section
2 272(b)(5) requires that the transfer price for such services be set at arm's length.

3
4 10. *Imputation of access charges and other tariffed services.* Sec. 272(e)(3), which remains
5 in full force and effect even after the separate affiliate requirement has been sunset, requires that
6 "a Bell operating company ... shall charge the affiliate described in subsection (a), or impute to
7 itself (if using the access for its provision of its own services), an amount for access to its tele-
8 phone exchange service and exchange access that is no less than the amount charged to any
9 unaffiliated interexchange carriers for such service." Access charges applicable to interexchange
10 carriers remain set well in excess of cost – perhaps by a factor of at least ten times. By requiring
11 that the *price*, not the *cost*, of access be imputed into the BOC's cost of providing retail long
12 distance service, the Act places a BOC in the same position as a nonaffiliated IXC with respect
13 to the cost of obtaining access to the BOC's local customers.

14
15 11. The separated Sec. 272 affiliate is required to purchase and to utilize access and other
16 "telephone exchange services" in exactly the same way as any nonaffiliated IXC – i.e., to
17 purchase or provide dedicated transport to its Point of Presence ("POP") where the access
18 connection is accomplished at a BOC end office, or to pay for common transport and tandem
19 switching where the access connection occurs at a BOC access tandem. The affiliate is also
20 required to pay for end office switching and for other miscellaneous access service rate elements,

1 as required. The affiliate must also purchase and pay for any other BOC telecommunications
2 services at full tariff rates. However, once integrated with the BOC, the BOC's interLATA long
3 distance services may be reconfigured so as to "ride" the BOC's network along with other BOC
4 local and intraLATA traffic *rather than to utilize discrete access and other telephone exchange*
5 *services per se*. Even where such reconfigurations produce efficiency gains, gains directly
6 attributable to integrated operations, *the BOC is still required by Sec. 272(e)(3) to impute into its*
7 *interLATA services the same access charges that it would have paid as a separate affiliate and*
8 *that its nonaffiliated competitors will continue to pay*, irrespective of the actual network facilities
9 arrangements that are being utilized. The elimination of the separate affiliate requirement may
10 enable the integrated local/long distance carrier to reconfigure its network and routing so as to
11 produce local and long distance services at a lower *combined* cost than would have been possible
12 under structural separation. In that event, Sec. 272(e)(3) operates to ensure that *all of these gains*
13 *from integrated operations inure to the benefit of the BOC's local services*. In addition to
14 furnishing access services to the separate Sec. 272 affiliate, the BOC also provides the affiliate
15 with a variety of *non-access* services, including joint marketing, customer service, billing and
16 collection, and various corporate overhead and management functions, such as human resources,
17 payroll, legal, accounting, procurement, and overall corporate governance. In its order issued
18 March 17, 2004, the Commission now also permits the BOC to provide the affiliate with a

1 variety of operations, installation and maintenance (“OI&M”) functions as well.⁵ The ability of
2 the affiliate to obtain access to BOC facilities and services enables the parent RBOC to realize
3 some, albeit less than all, of the potential gains from full integration.

4
5 12. Transactions between the BOC and its Section 272 affiliate with respect to non-access
6 tariff services and other non-tariff functions, resources and services are governed by Sec.
7 272(b)(5), Sec. 272(c), and by the Commission’s affiliate transaction rules, 47 C.F.R. §32.27.
8 These statutes and regulations operate to create a parallel transfer pricing and imputation
9 arrangement with respect to *non-access* transfers as applies in the case of access. Section 272(b)
10 requires that *all* transactions between the BOC and the Sec. 272 affiliate shall be conducted “on
11 an arm's length basis with any such transactions reduced to writing and available for public
12 inspection.” Sec. 272(c) requires that “In its dealings with its affiliate described in subsection
13 (a), a Bell operating company (1) may not discriminate between that company or affiliate and
14 any other entity in the provision or procurement of goods, services, facilities, and information, or
15 in the establishment of standards; and (2) shall account for all transactions with an affiliate
16 described in subsection (a) in accordance with accounting principles designated or approved by
17 the Commission.” Those “accounting principles” are set out at 47 C.F.R. §32.27 and require,
18 generally, that where the ILEC provides assets or services to an unregulated affiliate, the transfer

5. Section 272(b)(1)’s “Operate Independently” Requirements for Section 272 Affiliates, WC Docket 03-228, Report and Order, FCC 04-54, March 17, 2004.

1 price be set at the greater of fully distributed cost or fair market value, and that where an
2 unregulated affiliate furnishes services to the ILEC, such transfers be made at the *lesser* of fully
3 distributed cost or fair market value. The *effect* of these requirements is to accomplish with
4 respect to *non-access* transfers the same *economic* result as is accomplished through the
5 “imputation of full access rate” requirement – *viz.*, to facilitate realization of integration
6 efficiencies while assuring that the gains from such integration inure to benefit of the LEC’s
7 regulated services.

8
9 13. Prior to the sunset of the Section 272(b)(5) "arm's length" requirement, all costs of
10 RBOC provision of interLATA services were booked as expenses reflected on the interLATA
11 affiliate's books, facilitating the determination of a price floor for interLATA services and
12 further assuring that the BOC was being compensated for services being furnished by it to the
13 Sec. 272 affiliate. Thus, in addition to making costs transparent, Section 272(b)(5) served to
14 ensure that the benefits of economies of scope that are available to a BOC providing support
15 functions to its affiliate would remain with the BOC and inure to the benefit of the BOC’s
16 monopoly services. Since most of the relevant economies of scope stem directly from a BOC’s
17 legacy local service monopoly, allowing a BOC to pass those savings on to its affiliate com-
18 peting in an adjacent, and fully competitive, market would provide the affiliate with an unfair
19 cost advantage, one that was not available to any nonaffiliated IXC, and operate to divert

1 revenues that are being generated through the use (by the affiliate) of the BOC's assets and other
2 resources over to the affiliate.

3
4 14. Although the Section 272(e)(3) access charge imputation requirement remains in full
5 force and effect even after the sunset of the Section 272(a) separate affiliate requirement, the
6 Section 272(b) transaction rules and the Section 272(c) nondiscrimination requirement are
7 included within the provisions that are subject to the sunset. Without an equivalent replacement
8 regulation, which the Commission has full authority to require under sections 201-205, 215, 218
9 and 220, the potential for a price squeeze and similar anticompetitive conduct on the part of the
10 (now integrated) BOC becomes even greater than before, because a key set of safeguards will
11 have been eliminated.

12
13 **The same imputation standard is required for non-access services and functions under**
14 **local/long distance integration.**
15

16 15. In order to ensure that LEC long distance pricing reflects just and reasonable costs for
17 joint functions provided in conjunction with local services, ILECs should be required to impute
18 into long distance prices charges for all joint functions and the joint use of ILEC assets or
19 resources that would satisfy the requirements of Sec. 272(e)(3) with respect to access and, for
20 non-access services and functions, would satisfy the Commission's affiliate transaction rules as
21 codified at 47 C.F.R. §32.27. Although the ILEC's local and long distance operations will be

1 integrated, the use of affiliate transaction rules as a basis for cost assignment will help to ensure
2 that the gains from integrated provision of access and non-access services and functions are
3 treated on an entirely equivalent and parallel basis, and are not used by the ILEC to afford itself
4 an undue competitive advantage or to discriminate against and thereby to disadvantage the
5 ILEC's long distance rivals.

6
7 16. Non-access functions and services fall into two distinct categories, each of which
8 requires separate treatment for imputation purposes:

9
10 (1) Functions for which the gain from integration is directly attributable to the BOC's
11 status as the legacy local service monopoly. Such functions include access to the
12 BOC's legacy local service customer base (joint marketing of local and long distance
13 services, OI&M, and billing and collection). Access services also fall into this
14 category, and the Sec. 272(e)(3) imputation requirement recognized and accommodates
15 this fact.

16
17 (2) Functions and services of a general nature, where the integration efficiency is more one
18 of scale than of scope, arising from the size of the BOC rather than from its incumbency
19 in the local telephone service market. Such functions would include human resources,
20 payroll, legal, accounting, procurement and purchasing, real estate, and overall
21 corporate governance.

1 17. Integration gains in category (1) are uniquely available to the incumbent LEC, whereas
2 integration gains in category (2) would be available to any multi-product firm of comparable
3 size. Different imputation requirements for each category are appropriate.

4
5 (1) For functions for which the gain from integration is directly attributable to the BOC's
6 status as the legacy local service monopoly, BOCs should be required to identify the
7 portion of a given activity or resource that jointly benefits its provision of local and
8 long distance service. For the purposes of pricing long distance services, the BOC
9 would be required to apply the following procedures for imputing charges to its long
10 distance operations:

11
12 (a) Where 47 C.F.R. §32.27(d) would permit the use of prevailing company price
13 (PCP) for services that meet the Commission's PCP requirements (i.e., where at
14 least 25% of such services are being furnished to nonaffiliated entities), the
15 prevailing company price(s) being charged to nonaffiliated entities would be
16 imputed. (Note that with the sunset of the Section 272(c) nondiscrimination rules,
17 the 0% threshold for services provided to Section 272 affiliates is no longer
18 appropriate.) An example of such PCP-qualifying joint costs would be billing and
19 collection services.

20
21 (b) Where a service or activity does not qualify for PCP, the greater of fair market
22 value/estimated fair market value or fully distributed cost would be imputed into

1 the price floor for long distance services. As noted in the *Accounting Safeguards*
2 *Order*, fair market value, should be determined by “requiring carriers to use
3 methods that are routinely used by the general business community.”⁶ These
4 methods can include best use, appraisals, catalogs listing similar items, competitive
5 bids, replacement cost of an asset, and net realizable value of an asset.

6
7 (2) For functions and services where the integration efficiency arises from scale rather than
8 from scope, costs should be allocated between local and long distance services on the
9 basis of fully-distributed costs. In this manner, gains from integration are ratably
10 shared across all of the BOC products and services that are being supported by these
11 various overhead functions.

12
13 The distinction between these two types of activities corresponds with the distinction between
14 “joint” vs. “common” costs that is widely recognized by economists and accountants.

15
16 18. Integration gains associated with joint production of monopoly and competitive services
17 should inure to the monopoly service, because such gains are uniquely available solely to the
18 monopoly service provider. By contrast, integration gains associated with common overhead

6. *Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150, *Report and Order*, FCC 96-490, 11 FCC Rcd 17539, 17610 (1996), at para. 154.

functions are available to any firm of comparable size, and should thus be spread equitably across all of the products and services that such common overhead functions support.

Satisfaction of the imputation requirement, and establishment of price floors, must be done on a service-by-service basis so as to minimize the potential for cross-subsidization and other anticompetitive pricing conduct.

19. As part of their “joint marketing” of local and long distance services, the BOCs and their Sec. 272(a) long distance affiliates have been introducing service “bundles” that include regulated basic local exchange access, local and intraLATA toll calling, discretionary (and sometimes flexibly priced under state PUC tariffs) vertical features, and nonregulated services such as long distance, voice mail, and wireless services furnished by one or more BOC affiliates. Because the individual components of these “bundles” confront widely varying competitive conditions, it is essential that an imputation test with respect to each *competitive service* component of the bundle be applied separately for each such component. The potential for similar cross-subsidization also exists with respect to services furnished on an *a la carte* basis if the RBOC is allowed to satisfy imputation on an aggregate, rather than service-by-service.

20. Bundling of local and long distance services enables the BOC to exploit its market power with respect to local dial tone into the adjacent long distance market. And although local exchange access rates are, for the most part, still subject to regulation, BOCs have been afforded considerable pricing flexibility and, in some cases, outright de-tariffing, of a number of

discretionary service elements that are built on the basic local dial tone platform. These service elements fall into two principal categories:

(1) *Services and features that can be provided by the BOC only to customers who also take basic dial tone service from the BOC.* Examples of such services include local (non-toll) calling, switched access to/from long distance carrier services, certain vertical and CLASS features, such as call waiting, caller ID, voice mail with call waiting and/or caller ID, selective ringing, call forwarding (all varieties), and *69 call return.

(2) *Services and features that utilize the dial tone line platform and that can be provided by the BOC, but which are also available from other sources, albeit sometimes in a more cumbersome manner.* Examples include speed dialing, 3-way calling, voice mail (without call waiting or caller ID), and conference calling, in addition to intraLATA and interLATA calling.

Because services in category (1) cannot be obtained from a carrier other than the one that provides the customer's basic local dial tone access line, they provide the BOC with greater profit opportunity than for services in category (2). Since the BOCs continue to control the overwhelming share of the local dial tone market, their pricing discretion with respect to any services in this category that are not subject to price regulation is constrained principally by demand elasticities. Services in category (2) confront competition from alternative sources, limiting the BOCs' pricing opportunities to competitive market conditions.

1 21. If the BOCs were permitted to use profits obtained from services in category (1) to
2 cross-subsidize the competitive services in category (2), the result would be to undermine com-
3 petition in these otherwise competitive services. If a service bundle combining category (1) and
4 category (2) services were required only to satisfy an imputation test *in the aggregate* – i.e.,
5 across all of the components of the bundle combined – there would be no means for detecting,
6 let alone preventing, precisely this type of cross-subsidization.

7
8 22. It is for this reason that the price floor including imputation needs to be satisfied
9 individually for each of a BOC's various long distance services and pricing options so as to
10 preclude the possibility of revenues/profits from any noncompetitive *a la carte* services, or from
11 one or more noncompetitive components of a service bundle, being used to cross-subsidize *a la*
12 *carte* or bundled long distance services. Additionally, any bundle consisting of basic local
13 exchange (dial tone) service, local calling, vertical features, intraLATA and interLATA toll, and
14 any other components or features must be priced, in the aggregate, at a level sufficient to recover
15 the aggregate of all tariff prices of all tariff services (or their functional equivalents) included
16 within the bundle (e.g., local dial tone, local calling, vertical features) together with all other
17 imputed and directly-assigned costs applicable to the bundled offering. A service-by-service
18 imputation requirement puts the BOC in essentially the same economic condition as its non-
19 affiliated rivals. The BOC should be required to demonstrate, for each identifiable long distance
20 service offering or long distance component of a service bundle, as well as for the bundle as a
21 whole, that the revenues being derived therefrom exceed the sum of the access charges and

1 other tariff rates that it would have had to pay were it a separate, nonaffiliated entity *plus* the
2 imputed and actual non-tariff costs it incurs in providing the service or bundle at retail.

3
4 23. Where a service offering consists of a bundle of multiple services (such as local dial
5 tone, vertical features, and long distance) under a single, unified pricing plan, the effective
6 additional charge for the long distance component in the bundle (i.e., the difference between the
7 price of the bundle with long distance and the price of the bundle without it) should similarly
8 exceed the sum of imputed access charge (or other underling services being furnished by the
9 BOC) plus the additional non-access costs. For example, Verizon New England offers
10 customers in Eastern Massachusetts a bundle of local service, vertical features and intraLATA
11 toll at a monthly rate of \$39.95, but also offers an otherwise comparable bundle, but without any
12 toll, for \$37.95. Hence, Verizon New England's retail price for *unlimited intraLATA toll* is only
13 \$2 a month. Similarly, Verizon New York offers a New York Metro LATA bundle including
14 unlimited local and intraLATA calling, plus an array of vertical features, for \$44.95, but also
15 offers the same bundle but without intraLATA calling for \$42.95, also implying a \$2 per month
16 price for unlimited intraLATA usage. It is this \$2 price for unlimited intraLATA toll calling,
17 and not the full price of the bundle, that should be required to satisfy the imputation requirement,
18 i.e., to exceed an imputed price floor based upon the average volume of intraLATA calling that
19 customers of this service present.

20
21 24. Individual services differ both with respect to costs and revenues. Carriers will
22 typically incur higher customer acquisition costs with respect to high-value services, such as flat-

1 rated bundles of local, long distance, Internet access, and perhaps even wireless, than they would
2 to acquire, for example, a by-the-call long distance customer. Other costs, such as the fixed
3 components of billing and collection and customer service functions, may be somewhat lower
4 for customers with high calling volumes or who take multiple services in a package or bundle.
5 On the revenue side, competition will work to narrow the potential operating margin. While
6 there is a general requirement that the price of a bundle of services be profitable relative to the
7 cost of the entire bundle, there is a special imputation requirement where a portion of the bundle
8 consists of monopoly BOC local services and service features that are integrally linked to the
9 basic dial tone platform. In such an event, a BOC must not be permitted to use revenues from
10 the highly profitable vertical features that are included in a service bundle to cross-subsidize the
11 long distance components of that bundle. For such purposes, the “price” of the long distance
12 component may be determined as the difference between the price of the entire bundle including
13 long distance and the price of an equivalent bundle or collection of services *except for long*
14 *distance*.

15
16 25. Carriers frequently offer *promotional pricing* as an inducement to attract new
17 customers. Such promotions may consist of free or discounted service for a limited number of
18 months and/or an up-front cash (or other in-kind) payment to the customer for signing up for the
19 service. The service-specific imputation requirement should apply to such offerings, to be
20 satisfied over the average service retention period (up to twelve months) or contractual term,
21 whichever is greater. For example, if a BOC offers a competitive long distance service for \$25
22 with the first month free and no installation charges, and the average retention period for the

1 service is twelve months, the effective monthly price for the service would be computed as
2 $(11 \times \$25)/12 = \22.92 , which would need to exceed the imputed charges, *including installation*
3 *costs*, applicable to the service.
4

5 26. If the promotional offer is linked to a bundle that includes any category (2) components,
6 for imputation and price floor purposes the promotional discount must be applied solely with
7 respect to the additional charge for the category (2) component(s). For example, supposing that
8 a BOC offers a bundle consisting of local dial tone, unlimited local calling, and a collection of
9 vertical features for \$40 but without any promotion or discount, and also offers a similar bundle
10 but including unlimited intraLATA and interLATA calling for \$55 per month with the first
11 month free. The differential price of the intraLATA/interLATA calling feature is \$15 per month
12 (i.e., \$180/year), but the \$55 value of the “free” month must be applied solely with respect to this
13 intraLATA/interLATA component, bringing its effective price to \$125 per year, or \$10.42 per
14 month. It is this \$10.42 that must satisfy the imputation test with respect to access charges and
15 any non-tariff services that are associated with the long distance component of the bundle.
16

17 **The existing processes for allocating costs between an ILEC’s regulated and nonregulated**
18 **operations, as set forth at 47 CFR §64.901 are not sufficient to properly address the vast**
19 **amount of joint costs present in the integrated provision of regulated local and**
20 **nonregulated long distance services.**
21

22 27. Under the Commission’s current Part 64 allocation rules, revenue, expense and
23 investment accounts are analyzed for the purpose of separating these items as between regulated

1 and nonregulated services. However, once placed in the “nonregulated” column, no further
2 disaggregation, e.g., on a service-by-service basis, is required. As explained in my July 28, 2003
3 Reply Declaration appended to AT&T’s Reply Comments in this proceeding, competitive
4 services such as long distance should continue to be treated as non-regulated under Part 64 such
5 that these costs and associated revenues may be isolated from those applicable to regulated
6 monopoly services.⁷ However, the Part 64 allocations do not identify revenues and costs
7 associated with long distance services for the purposes of imputation. Since the costs and
8 revenues for nonregulated services are typically aggregated for the purposes of Part 64, revenues
9 and expenses associated with long distance products are mixed in with many other nonregulated
10 services provided by the carrier, such as inside wire maintenance and DSL. This aggregation of
11 products serves to conceal the costs and revenues specifically associated with long distance
12 products, and makes any long distance imputation test that might be based upon Part 64 alloca-
13 tions impossible. Part 64 should be modified to require that nonregulated costs and revenues be
14 allocated according to the modifications I have recommend here, and be maintained on a dis-
15 aggregate basis, by product line.

16
17 28. Part 64 and the various RBOC cost allocation manuals that purport to implement them
18 generally separate expenses and investments as between regulated and nonregulated services on
19 the basis of fully-distributed costs, with the specific allocations typically driven *not* by cost-
20 causation factors, but instead by arbitrary allocators based upon, for example, relative usage or

7. Selwyn (AT&T) Reply, filed July 28, 2003, at para. 57.

1 other simple metrics. An RBOC's motivation for a particular plant acquisition or upgrade may
2 be for the purpose of furnishing a nonregulated service, but once acquired or upgraded the plant
3 may be used jointly to furnish regulated and nonregulated services. In such an event, the costs
4 associated with such newly acquired or upgraded plant would then be apportioned between these
5 two categories in some manner than would bear no economically rational relationship with the
6 cost drivers themselves.

7
8 29. For example, a BOC might replace perfectly serviceable copper loop plant with fiber for
9 the sole and express purpose of providing nonregulated broadband services. If, once in place,
10 the new fiber optic facility is also used to provide plain old telephone service (POTS), then a
11 potentially large portion of its cost would, under Part 64, be allocated to POTS and away from
12 the nonregulated broadband service. If the nonregulated broadband services are then co-mingled
13 with nonregulated long distance services, the "profits" available from broadband (due to the
14 underallocation of costs to broadband) could then be used to cross-subsidize long distance. Part
15 64 is not, as presently constituted, an effective tool either for detecting or for preventing such
16 cross-subsidization.

17
18 30. Part 64 should be modified so as to specifically address this concern. Absent a showing
19 to the contrary, all BOC investments in plant, facilities or equipment that will be jointly used for
20 the benefit of regulated and nonregulated services within five years of the date of acquisition and
21 installation of that plant should be presumed to have been acquired primarily for the benefit of
22 the nonregulated services. Based upon this (rebuttable) presumption, any increase in net invest-

ment for the replacement assets in excess of the remaining net book cost of the plant being replaced should be allocated to and imputed into the price floor applicable to the nonregulated service.

Enforcement of any imputation standard – including the imputation of access charges and other tariff services as required by Sec. 272(e)(3) – requires dominant carrier treatment of integrated BOC long distance services.

31. As a practical matter, the statutory requirement for access charge imputation at Sec. 272(e)(3) could neither be monitored nor enforced – except perhaps long after-the-fact – if BOC long distance services are afforded non-dominant status. Non-dominant treatment by the FCC of BOC long distance services would work to exempt the BOCs from filing interstate tariffs for their long distance, private line, and other services, without which there would be no mechanism for the Commission to review, let alone enforce, the statutory imputation requirement. After-the-fact enforcement would necessarily involve protracted delays, during which time the BOC would be able to violate the statutory requirement (along with any other regulatory imputation requirements that the Commission may impose, such as those discussed above) and in so doing impose an unlawful price squeeze upon nonaffiliated IXC.

32. Rapidly increasing RBOC in-region long distance market shares are *in and of themselves* fully sufficient to justify subjecting the BOCs to dominant carrier regulation, *even where the RBOCs continue to operate their long distance business through a separate affiliate.*

1 Figure 1 below is a reproduction of a chart that was provided by Verizon at its January 29, 2004
2 quarterly securities analyst briefing to present its fourth quarter 2003 results. In this chart,
3 Verizon provides its retail long distance market shares of local consumer service customers,
4 *state-by-state*. Only four years after gaining Section 271 in-region authority in New York,
5 Verizon had amassed an impressive 61% share; after only three and a half years in
6 Massachusetts, Verizon's share had reached 52%. Verizon is not alone in its ability to gain
7 overwhelming market share through its ability to exploit its preexisting dominance of the local
8 service market. As shown in Figure 2, SBC announced that it had achieved a nearly 60% market
9 share in Texas only 39 months after entry, with similar trends in Kansas, Oklahoma, Missouri,
10 Arkansas and California.⁸ Using the data contained on these two charts, I constructed a linear
11 regression analysis for the former Bell Atlantic and NYNEX Verizon states (those that were
12 subject to Section 271) and the six SBC states included in Figure 3, with the RBOCs' retail share
13 in each state as the dependent variable and the months since long distance entry as the principal
14 explanatory variable (see Figure 3 below). Attachment 1 provides the regression results and the
15 source data used. The model revealed a highly significant relationship between the months since
16 entry and market share, with a *t*-statistic of 19.65, indicating statistical significance in excess of
17 99.9%. The explanatory power of the model was also quite high, as indicated by an R^2 of .93,
18 i.e., that time since entry explains 93% of the variation in achieved market share. The model

8. SBC Analyst Conference 2003, at slide 10, available at: http://www.shareholder.com/sbc/downloads/AnalystPres_nov03.pdf.

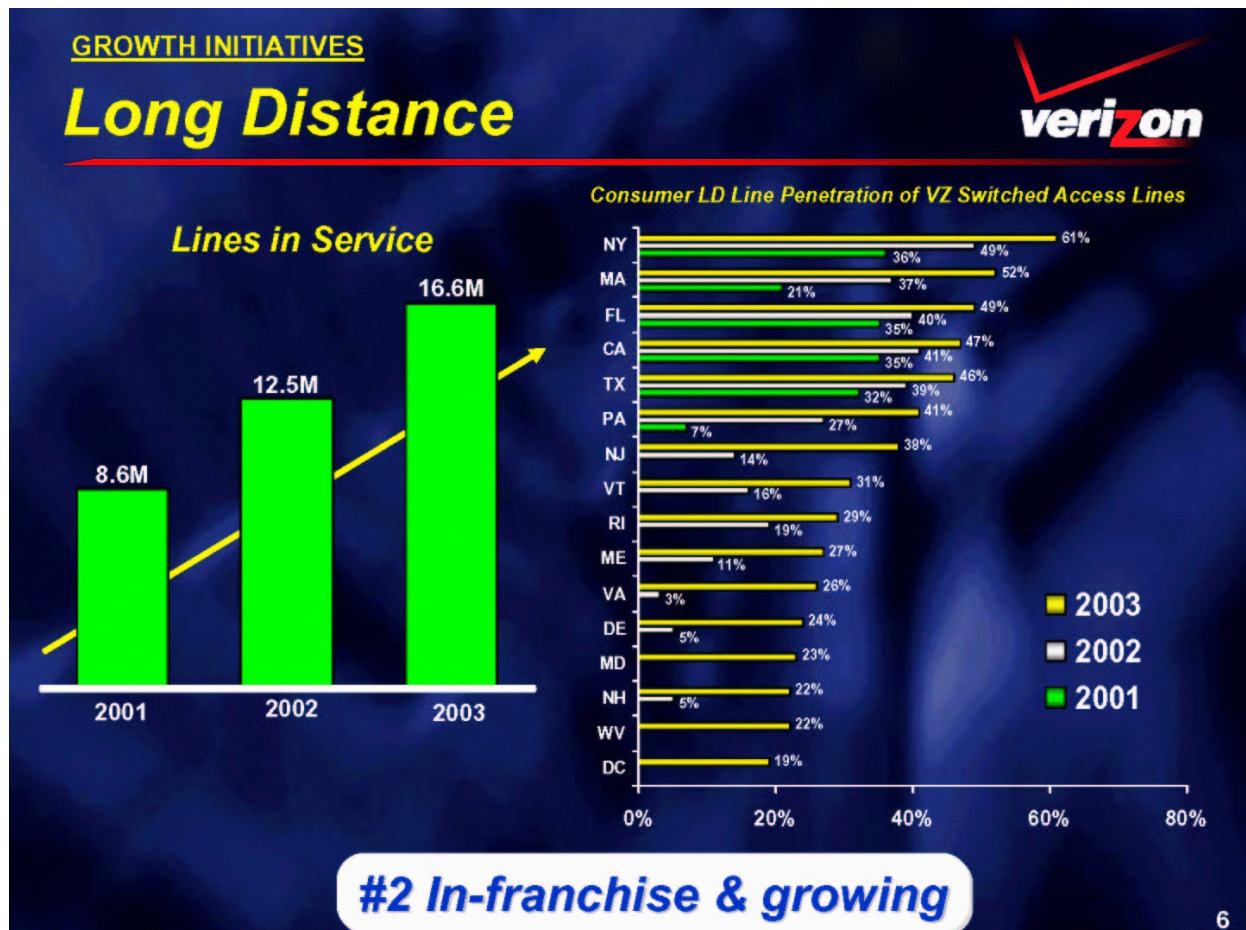


Figure 1. Verizon Long Distance Penetration.

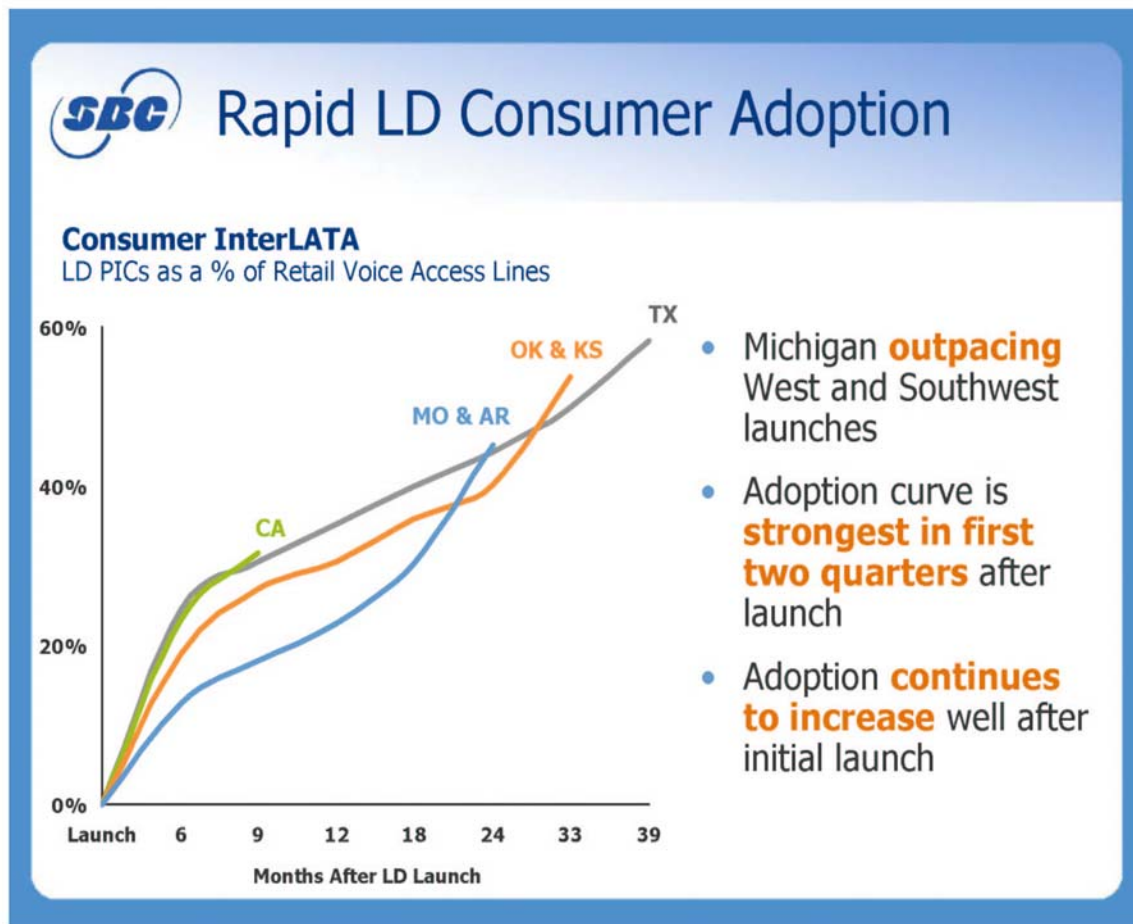


Figure 2. SBC Long Distance Shares

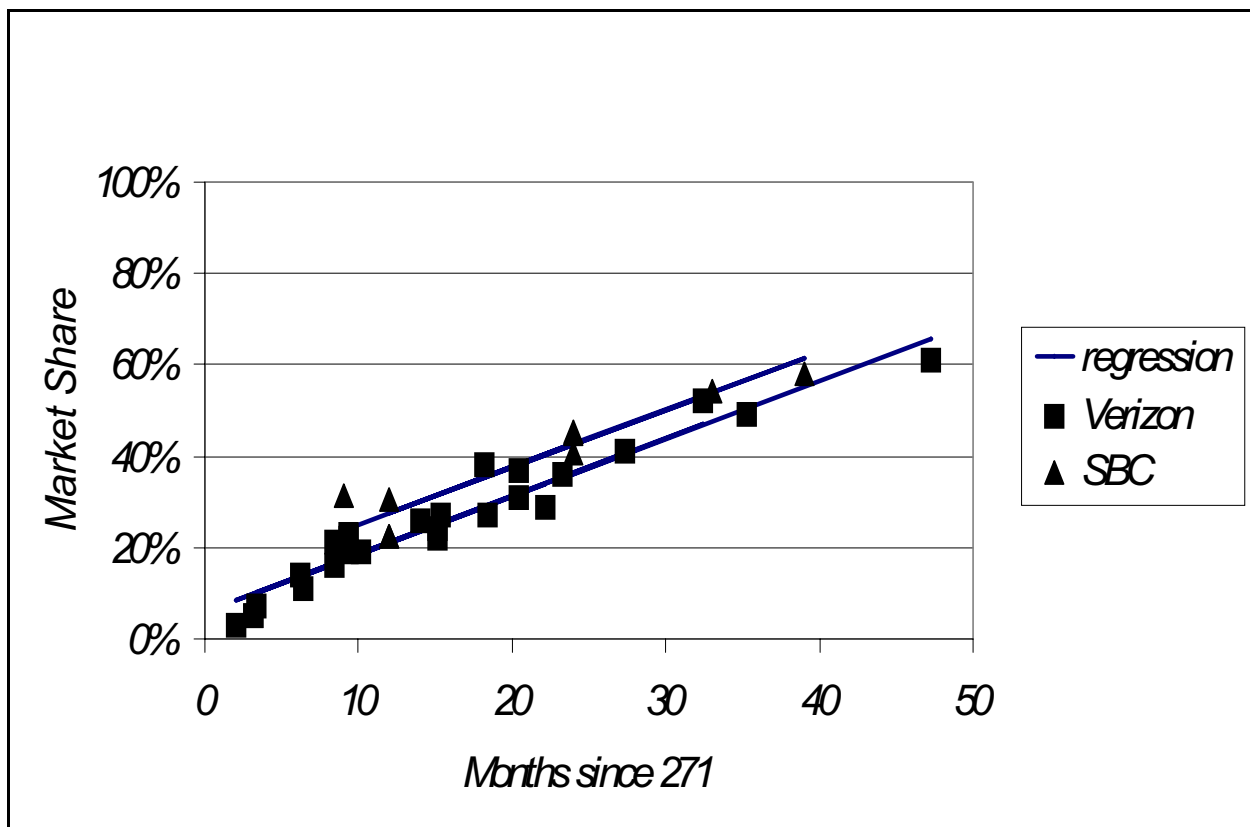


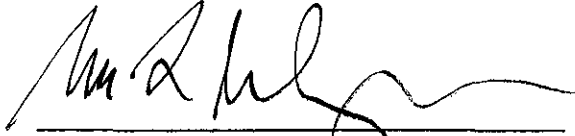
Figure 3. Regression output analysis of Verizon and SBC Long Distance market share (by stste) by length of time since 271 approval.

1 indicates that Verizon and SBC have been able consistently to acquire an additional 1.27%
2 market share per month since initial entry into a given jurisdiction. Even in the states with the
3 longest RBOC long distance presence, the rate of market share growth shows no sign of slowing.
4 Moreover, it appears that the RBOCs' rate of market share acquisition has actually improved as
5 they gained entry in successive states, suggesting that the companies are getting even better in
6 exploiting their legacy local service customer base as they gain additional experience in
7 marketing long distance service.⁹ These real-world market outcomes also demonstrate that the
8 separate affiliate and affiliate transactions requirements of Section 272 have certainly not
9 impaired the RBOCs' competitive effectiveness in capturing retail long distance market share.

9. I would note that in a Declaration I submitted on May 3, 2002 on behalf of AT&T in the Virginia State Corporation Commission's Section 271 consultative proceeding, Case No. PUC-2002-0046, I presented the results of a simulation model that I had developed for the purpose of predicting the growth in Verizon's long distance market share stemming, specifically, from its ability to exploit the "inbound channel" – incoming calls placed by customers to Verizon for the purpose of ordering new *local* telephone service. My model had predicted that after four full years of long distance entry, Verizon would have captured a 55.8% share. As it turns out, my prediction was conservative, since Verizon has achieved a 61% share after four years in New York. In a declaration I submitted to the California Public Utilities Commission on behalf of Pac-West Telecomm and Working Assets Long Distance, I provided the California results of the same model. Again, my model under-predicted California results, projecting less than 20% long distance market share in the first year, whereas SBC has announced a 31% market share after nine months. *Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks*, R.93-04-003, *Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks*, I.93-04-002, *Order Instituting Rulemaking on the Commission's Own Motion Into Competition for Local Exchange Service*, R.95-04-043, *Order Instituting Investigation on the Commission's Own Motion Into Competition for Local Exchange Service*, I.95-04-044, Declaration of Lee L. Selwyn, August 23, 2001.

- 1 33. Appendix 1 to this Declaration provides sample text for an imputation rule that is
- 2 intended to address the various issues I have discussed herein.

The foregoing statements are true and correct to the best of my knowledge, information and belief.



LEE L. SELWYN

APPENDIX

DRAFT IMPUTATION RULE

1. Applicability of Section 32.27 to integrated local/long distance operations

- (a) Whenever a dominant provider of local exchange service that also provides long distance services has elected to offer long distance services through a separate affiliate, those transactions shall be subject to Section 32.27 of the Commission's rules.
- (b) Whenever a dominant provider of local exchange service that also provides long distance services has elected to operate on an integrated basis, rather than providing its long distance services through a separate affiliate, then, for purposes of imputing costs to that provider's long distance services, the requirements of section 32.27 of the Commission's rules shall apply as though the long distance services were being provided through an affiliate.
- (c) In no event shall the retail price of any long distance service being furnished by a dominant provider of local exchange service that also provides long distance services be set less than the sum of items 2(b)(1) through 2(b)(5) and 2(c) below, plus any incremental network or other costs required for the provision of long distance service.

2. Imputation cost standard applicable to each category of cost

- (a) For purposes of imputation, a distinction is made among three types of costs – “direct costs,” “joint costs,” and “common overhead costs.”
 - (1) “Direct costs” are incurred for the production of a specific product or service and are avoided in their entirety if such service is not provided. “Direct costs” may include both fixed components as well as variable components that increase (although not necessarily in direct proportion to) the quantity of the product or service that is being produced.
 - (2) “Joint costs” are incurred for the production of two or more products or services and not avoided as long as at least one such product or service continues to be produced.
 - (3) “Common overhead costs” relate to functions of a general business nature not specifically associated with any product or group of products. “Common overhead costs”

may include both fixed components as well as variable components that increase (although not necessarily in direct proportion to) the overall scale of the enterprise.

Direct costs and Joint costs shall be imputed into the price of long distance services furnished by a dominant provider of local exchange service in accordance with 2(b) following; Common Overhead costs shall be imputed into the price of long distance services furnished by a dominant provider of local exchange service in accordance with 2(c) following.

(b) For purposes of imputation for any long distance service furnished by a dominant provider of local exchange service that also provides long distance services, the following shall apply:

(1) *Access services.* For purposes of imputation, the tariff prices of all switched and special access services that would ordinarily be utilized by a section 272(a) affiliate or by a non-affiliated provider of interexchange services shall be utilized, whether or not such services are actually being utilized by the integrated provider in the specific network architecture applicable to an integrated dominant provider of local exchange service that also provides long distance services.

(2) *Non-access tariff services.* For purposes of imputation, the tariff prices applicable to all non-access local exchange services that would ordinarily be utilized by a section 272(a) affiliate or by a nonaffiliated provider of interexchange services shall be utilized, whether or not such services are actually being utilized by the integrated provider in the specific network architecture applicable to an integrated dominant provider of local exchange service that also provides long distance services.

(3) *Non-tariff services or functionality satisfying the Prevailing Company Pricing threshold set out at 47 CFR 32.27(d).* For purposes of imputation, the prevailing company prices applicable to all non-tariff services of a type or providing a functionality that would be offered to and, in some cases, utilized by a section 272(a) affiliate or by a nonaffiliated provider of interexchange services, where the level of utilization by nonaffiliated entities is sufficient to satisfy the Prevailing Company Pricing threshold set out at 47 CFR 32.27(d), the Prevailing Company Price as it would be set in accordance with 47 CFR 32.27(d) shall be utilized, whether or not the precise manner in which the integrated provider furnishes such functionality to itself is the same as that which is being offered to nonaffiliated entities.

(4) *Non-tariff services, functionality, information or the beneficial transfer of assets not satisfying the Prevailing Company Pricing threshold set out at 47 CFR 32.27(d).* Where non-tariff services, information or the beneficial transfer of assets of a type or providing a functionality that would be provided to a section 272(a) affiliate but whose usage by one or

more nonaffiliated providers of interexchange services is not sufficient to satisfy the Prevailing Company Pricing threshold set out at 47 CFR 32.27(d), for purposes of imputation the fair market value or the fully-distributed cost, whichever is greater, shall be used. The fair market value of such services shall be determined by a survey of prices of comparable services being offered on a stand-alone basis by firms ordinarily in the business of providing such services,

(5) *Non-tariff functionality or the beneficial transfer of information or assets not offered or available to nonaffiliated entities.* Where the production of long distance services on an integrated basis by a dominant local exchange service provider involves the use of non-tariff services, functionality, information, or the beneficial transfer of assets of a type or providing a functionality that would be provided to a section 272(a) affiliate but which is not required to be offered to nonaffiliated providers of interexchange services, imputation shall be based upon the fair market value or the fully-distributed cost, whichever is greater, of such service, functionality, information, or the beneficial transfer of assets, including in particular the fair market value of any customer proprietary network information that is used or referenced during the course of marketing, selling, or furnishing the long distance service. The fair market value of such services or functionality, including any customer proprietary network information, shall be based upon the cost that a provider of interexchange services that is not affiliated with a dominant incumbent local exchange carrier would reasonably incur in order to obtain or to self-provide such services, functionality and/or information.

(c) Common Overhead costs shall be imputed to long distance services furnished by a dominant provider of local exchange service on the basis of fully distributed cost.

3. Service-specific imputation required

(a) A dominant provider of local exchange services that is required to impute costs to its long distance services pursuant to these rules must satisfy such imputation requirements separately with respect to each of its retail long distance services.

(b) Where such long distance service is included within any bundled offering that also includes any dominant local exchange services or service elements, the price of such long distance service to which the imputation requirement is to apply shall be determined by subtracting the retail price(s) of all component(s) of the bundle other than long distance from the total retail price of the bundle.

(c) Any bundle consisting of basic local exchange (dial tone) service, local calling, vertical features, intraLATA and interLATA toll, and any other components or features must be priced, in the aggregate, at a level sufficient to recover the aggregate of all tariff prices of all tariff services (or their functional equivalents) included within the bundle together with all other imputed and directly-assigned costs applicable to the bundled offering.

4. Allocation of costs for upgrades or replacements

(a) All investments in plant, facilities or equipment that will be jointly used by regulated and nonregulated services within five years of the date of acquisition and installation of that plant shall be presumed to be acquired primarily for the benefit of the nonregulated services, absent a showing to the contrary.

(b) At a minimum, any increase in net investment for the replacement assets over the remaining net book cost of the plant being replaced shall be allocated to and imputed into the price floor applicable to the nonregulated service.

5. Cross-subsidization prohibited

(a) In no event shall a dominant provider of local exchange service that also provides long distance services and that has elected to operate on an integrated basis rather than providing its competitive long distance services through a separate affiliate engage in actions that constitute a cross-subsidization of its competitive long distance services from its regulated services.

(b) For purposes of this rule, “cross-subsidization” shall be deemed to occur when in-region long distance services or nonregulated services, or telecommunications services that are treated as nonregulated services under these rules, are priced below cost by use of subsidization from customers of regulated services; or when a provider’s in-region long distance services or non-regulated services derive benefits from the regulated operations without the regulated operations receiving just and reasonable compensation from in-region long distance services or nonregulated operations for the benefits derived by such in-region long distance services or nonregulated operations.

Attachment 3
SBC Announcements of Success
in Acquiring Enterprise Customers
WC Docket No. 02-112



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SBC Communications Announces Three-Year Contract with Applied Computer Solutions

SBC Companies to Provide Network-Based VPN Services for Systems Integration and Solutions Provider

San Antonio, Texas, February 22, 2005

SBC Communications Inc. (NYSE: SBC) today announced a new contract with California-based Applied Computer Solutions (ACS), a nationwide leader in systems integration which transforms software and hardware into customized computer systems. The company designs and installs database, network, Intranet, Internet, and computer security systems for customers in a variety of industries and operates in several locations across the nation, with multiple offices throughout California.

Under terms of the contract, SBC companies will deploy SBC PremierSERVSM Network-Based Virtual Private Network (NVPN), utilizing MPLS (Multi-Protocol Label Switching) technology, to provide ACS with speedy and flexible IP-based network connections to support the company's bandwidth-intensive applications at its headquarters and disaster recovery site, both located in California.

Additionally, the service will also support Voice over Internet Protocol (VoIP) communications between all seven of the company's California offices.

"We required a fully meshed network that is scalable and cost-effective for quick and secure data transport," said Craig Harrington, manager, Information Systems, Applied Computer Solutions. "We're confident that SBC companies will meet our needs by providing an advanced, MPLS-based network."

"SBC NVPN provides the flexibility and cost-effectiveness of VPN connections with high levels of security and service which will result in the secure, high-speed data transport Applied Computer Solutions required," said Bob Ferguson, group president & CEO, SBC Enterprise Business Services.

About Applied Computer Solutions

As a strategic solution provider, Applied Computer Solutions (ACS) offers our customers comprehensive solutions that enable their enterprise infrastructure. Utilizing our Professional Services organization and the finest technologies available, we build innovative solutions tailored to each client's unique requirements. Our experienced team develops solutions that create technological and business value, delivering solutions and tools that build upon the existing infrastructure foundation. The result: enterprise infrastructure optimization. With the combination of consulting, technology, support, and financing solutions—ACS is the single source for enterprise infrastructure needs. For more information, visit www.acsacs.com.

About SBC

SBC Communications Inc. is a Fortune 50 company whose subsidiaries, operating under the SBC brand, provide a full range of voice, data, networking, e-business, directory publishing and advertising, and related services to businesses, consumers and other telecommunications providers. SBC holds a 60 percent ownership interest in Cingular Wireless, which serves 49.1 million wireless customers. SBC companies provide high-speed DSL Internet access lines to more American consumers than any other provider and are among the nation's leading providers of Internet services. SBC companies also now offer satellite TV service. Additional information about SBC and SBC products and services is available at www.sbc.com.

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SBC Communications Announces New Data Networking Contract With Dickinson Wright PLLC***Five-Year Contract Expands Upon Existing Relationship with Detroit-Based Law Firm*****San Antonio, Texas, March 2, 2005**

SBC Communications Inc. (NYSE: SBC) today announced a new five-year data networking contract with Dickinson Wright PLLC, a Detroit-based law firm with more than 200 attorneys offering comprehensive legal services to a broad range of clients, including large corporations, small businesses, new ventures, individuals, and governmental units.

Currently the firm's primary provider for local and long distance voice services, SBC companies will be providing Dickinson Wright with Cisco Systems® Architecture for Voice, Video, and Integrated Data (AVVID) to replace older PBX switches for the firm's five Michigan locations as well as its Washington, D.C., office.

In addition, SBC companies will also implement SBC PremierSERVSM Data CPE Support Services to provide network maintenance of the AVVID solution under the terms of the contract.

"We have maximized the technological resources available through SBC companies in order to create a uniform infrastructure for the Firm," said Michael Kolb, CIO, Dickinson Wright PLLC. "By converting to a pure IP environment, we have reduced our overall operational costs and created a true 'virtual office' that benefits our attorneys and the clients we serve throughout the nation."

"We're excited to be able to expand upon our existing relationship with Dickinson Wright," said Bob Ferguson, group president & CEO, SBC Enterprise Business Solutions. "The services we'll be providing to this respected Detroit law firm demonstrate our ability to meet both its voice and data services needs."

About Dickinson Wright PLLC

Dickinson Wright PLLC, founded in 1878, has more than 200 attorneys in offices located in Detroit, Bloomfield Hills, Lansing, Grand Rapids, Ann Arbor, and Washington, D.C. Dickinson Wright is a full-service law firm with more than 40 practice areas. For more information, visit www.dickinsonwright.com.

About SBC

SBC Communications Inc. is a Fortune 50 company whose subsidiaries, operating under the SBC brand, provide a full range of voice, data, networking, e-business, directory publishing and advertising, and related services to businesses, consumers, and other telecommunications providers. SBC holds a 60 percent ownership interest in Cingular Wireless, which serves 49.1 million wireless customers. SBC companies provide high-speed DSL Internet access lines to more American consumers than any other provider and are among the nation's leading providers of Internet services. SBC companies also now offer satellite TV service. Additional information about SBC and SBC products and services is available at www.sbc.com.

SBC PremierSERV Data CPE Support Services are provided by SBC DataComm, Inc. Long distance voice services are provided by SBC Long Distance, Inc. SBC local service is provided by SBC Michigan.

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Tips to protect yourself against potential Internet fraud.

SBC Communications Announces Voice and Data Networking Services Contract with Republic Bancorp Inc.***SBC Companies to Deliver Multiple Services to Large Midwest Banking Company*****San Antonio, Texas, March 9, 2005**

SBC Communications Inc. (NYSE: SBC) today announced a new three-year contract with Michigan-based Republic Bancorp Inc. (NASDAQ: RBNC), one of the state's largest banking companies with customers located throughout Michigan, Ohio, and Indiana.

In addition to local, long distance and toll-free conferencing services, SBC companies will provide Republic Bancorp with SBC PremierSERVSM Dedicated Internet Access (DIA), SBC PremierSERVSM Frame Relay, SBC PremierSERVSM Asynchronous Transfer Mode (ATM), and Synchronous Optical Network service (SONET) Services.

Together, these services will connect the bank's 94 retail, commercial, and mortgage banking locations as well as 89 of its ATM locations and will help Republic Bancorp improve vendor relations as well as enhance overall business communications across the company. In addition, the new network will allow Republic Bancorp to utilize disaster recovery components and will enable Internet access.

"We look forward to completely redesigning our network," said Greg Bixby, CIO, Republic Bancorp. "We're excited about the expanded capabilities which will allow greater flexibility, improved communications, and the scalability we require to assist with future expansion."

"We are pleased that Republic Bancorp has decided to consolidate its voice and data services with SBC companies," said Bob Ferguson, group president & CEO, SBC Enterprise Business Services. "We look forward to helping Republic Bancorp enhance its communications capabilities today and in the future."

About Republic Bancorp Inc.

Republic Bancorp Inc., with \$5.8 billion in assets, is a regional bank holding company specializing in Distinctive Personal Service and commercial, consumer, and mortgage lending. Republic is the third largest bank holding company headquartered in Michigan and the 79th largest bank holding company in the country. Its subsidiary, Republic Bank, serves customers in Michigan, Ohio, and Indiana with 94 retail, commercial, and mortgage banking offices and 89 ATMs.

About SBC

SBC Communications Inc. is a Fortune 50 company whose subsidiaries, operating under the SBC brand, provide a full range of voice, data, networking, e-business, directory publishing and advertising, and related services to businesses, consumers and other telecommunications providers. SBC holds a 60 percent ownership interest in Cingular Wireless, which serves 49.1 million wireless customers. SBC companies provide high-speed DSL Internet access lines to more American consumers than any other provider and are among the nation's leading providers of Internet services. SBC companies also now offer satellite TV service. Additional information about SBC and SBC products and services is available at www.sbc.com.

Long distance, InterLATA SBC PremierSERVSMFrame Relay, and InterLATA SBC PremierSERVSMATM services are provided by SBC Long Distance, Inc. SBC PremierSERVSM

Dedicated Internet Access service is provided by SBC Internet Services, Inc. Local and SONET services are provided by SBC local exchange telephone companies, based upon the service address.

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SBC Communications Announces Three-Year Deal with Financial Partners Credit Union***SBC Companies Provide Bundled Telecommunications Services for Financial Partners Credit Union, Downey Headquarters*****Los Angeles, California, March 21, 2005**

SBC Communications Inc. [NYSE: SBC] today announced a new servicing agreement with Financial Partners Credit Union to provide bundled telecommunications services for the not-for-profit financial organization.

The agreement is worth almost \$750,000 over the three-year life of the contract.

Under the agreement, SBC companies will provide the firm's headquarters, located in the city of Downey, with local, long distance, audio conferencing, and

Voice over Internet Protocol (VoIP) services. This contract represents a new revenue source to SBC companies as Financial Partners Credit Union is migrating from a competing telecommunications provider.

"SBC companies are pleased to provide Financial Partners Credit Union with a complete offering of bundled telecom services that meets their unique needs," said Jason Myers, regional vice president, SBC West. "I think this agreement serves as an example of our commitment to truly learning the landscape of a customer's business, and then closely working with the customer to develop a suite of services that provides them with both flexibility and value."

The agreement is the product of many months of close negotiations. SBC account team members began discussions with representatives from Financial Partners Credit Union in May 2004.

"We needed a higher level of service for our voice network, and it was important for us to consolidate multiple vendors into one single provider," said Patty Holcomb, vice president, information technology, Financial Partners Credit Union. "It became evident in our discussions with the SBC team that they were best prepared to be our telecommunications single point of contact. SBC

companies offers Financial Partners Credit Union the solutions, expertise, and the level of commitment that our organization requires to continue to provide our members with the trusted, convenient, and responsive service we have been providing for more than 60 years."

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Financial Partners Credit Union is a full-service not-for-profit financial organization. Established in 1937 by the aerospace industry to provide a means for people to avoid paying the high interest rates of that time, Financial Partners has since evolved into a leading Southern California credit union, with more than 58,000 members and over \$620 million in assets. Financial Partners was previously known as Rockwell Federal Credit Union. Its headquarters is in Downey , with branches throughout Southern California . Membership is available to anyone who lives, works or attends school in Orange County and most Los Angeles County cities. To find out more about Financial Partners Credit Union please call 800. 950.7328 or visit www.fpcu.org.

Local services provided by SBC California based upon the service address location. Long distance voice and audio conferencing services are provided by SBC Long Distance, Inc. VoIP services are provided by SBC Internet Services, Inc. SBC, the SBC logo and other SBC product names are trademarks of SBC Knowledge Ventures, L.P. or its affiliates. © 2005 SBC Knowledge Ventures, L.P. All rights reserved.



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SBC Communications Announces Agreement with the University of Arkansas

SBC Companies Help Deliver Reliable Internet Access on Campus Via Wireless Data Network

San Antonio, Texas, March 24, 2005

SBC Communications Inc. (NYSE: SBC) today announced an agreement with the University of Arkansas to provide a Wireless Mesh Network solution from Nortel for an on-campus private wireless network.

Under the terms of the agreement, SBC companies have delivered Nortel's Wireless Mesh Network solution for secure and seamless access to a wireless broadband service with a minimal amount of Ethernet cabling required to the University of Arkansas. This service gives both students and faculty secure wireless broadband access to educational and Internet resources anywhere on campus.

"We wanted a solution that would allow us to provide secure access to University resources in a wireless environment," said Craig Brown, associate director of Computing Services, University of Arkansas. "We succeeded in finding this with SBC companies."

"We appreciate the opportunity to deliver a powerful campus-wide wireless solution for the University of Arkansas, working directly with Nortel," said Charles Rudnick, president — Business Communications Services, SBC Southwest. "We are fully committed to working with our customers to deliver customized solutions that meet their specific individual needs."

About University of Arkansas

The University of Arkansas is located in Fayetteville , a city of nearly 60,000 residents and currently enrolls more than 16,000 total students in both the graduate and undergraduate programs. Fayetteville is at the southern tip of a metroplex that runs northward for 25 miles along I-540 through Washington and Benton counties in Northwest Arkansas . For more information about the University of Arkansas , visit www.uark.edu.

About SBC

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SBC Communications Announces Multimillion Dollar Contract with H-E-B***SBC Companies Provide Voice and Data Services to H-E-B Corporate Offices and Stores*****San Antonio, Texas, March 29, 2005**

SBC Communications Inc. (NYSE: SBC) today announced a new voice and data networking services contract with San Antonio-based H.E. Butt Grocery (H-E-B), one of the nation's largest independently owned food retailers with more than 300 supermarkets and 56,000 employees.

Under the terms of the three-year contract, SBC companies will provide H-E-B with SBC PremierSERVSM Network-based Virtual Private Network (NVPN), utilizing MPLS (Multi-Protocol Label Switching) technology, as the primary network architecture for all of its stores and corporate offices. SBC companies will also provide H-E-B with local access, long distance voice, and SBC PremierSERVSM Dedicated Internet Access (DIA) services.

Together, these solutions will not only provide H-E-B with reliable Wide Area Network (WAN) connectivity, but will also provide an additional level of redundancy to help protect the company's mission-critical applications, including inventory, point-of-sale, and financial data transactions.

"We were looking for a stable carrier that could provide us with a reliable Wide Area Network to support the services and applications that are critical to our business and our customers," said Shawn Sedate, vice president for IS at H.E. Butt Grocery. "We are confident that SBC companies will meet our network connectivity needs."

"We are excited to provide both voice and data networking services to H-E-B," said Bob Ferguson, group president & CEO, SBC Enterprise Business Services. "Our team understands the H-E-B business and we are confident that the delivery of our complete, managed communications services will add strong value to the company."

About H-E-B

For 100 years, H-E-B has been an innovative retailer. Known for its fresh food, quality products, and convenient services, H-E-B strives to provide the best customer experience at the lowest prices. Based in San Antonio, H-E-B proudly employs more than 56,000 partners and serves millions of customers in more than 150 communities throughout Texas and Mexico.

About SBC

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SBC Communications Announces Optical Networking Services Contract With The MetroHealth System***New Services Provide 'Ultra Bandwidth' to Help Increase Medical Center's Network Reliability*****San Antonio, Texas, April 8, 2005**

SBC Communications Inc. (NYSE: SBC) today announced a new data services contract with The MetroHealth System, a large academic medical center and Level I trauma center, operating 13 inpatient and outpatient facilities, including a comprehensive outpatient surgery center, and 10 community health sites throughout the Cleveland area.

Under the terms of the five-year contract, SBC companies will deploy SBC PremierSERVSM Optical Networking Solutions including OPT-E-MAN[®] (Optical Ethernet Metropolitan Area Network) and GigaMAN[®] (Gigabit Ethernet Metropolitan Area Network) services to provide the organization with a flexible high-speed fiber optic-based solution.

The services will provide The MetroHealth System with reliable transmission of bandwidth-intensive files and data while reducing network delays or bottlenecks to satellite locations and its new data center, which is due to be relocated two miles from the organization's main campus later this year.

As its application environment continues to grow, the services will also help support the organization's Picture Archiving Computer System (PACS) for medical imaging while also providing IP Telephony capabilities.

"We were looking for a highly-reliable, high-bandwidth solution that would also enable us to take advantage of more complex applications," said Vince Miller, vice president & CIO, The MetroHealth System. "Based on SBC companies' reputation in supporting optical solutions, we are confident they have the capabilities that will meet both our current and future needs."

"We're excited about our new relationship with The MetroHealth System," said Cathy Coughlin, president, Business Communications Services, SBC Midwest. "We're confident that our high-bandwidth, high-speed fiber optic services will provide the superior reliability, availability and efficiency that The MetroHealth System desires to deliver critical, often lifesaving services to patients."

About MetroHealth Medical Centers

The MetroHealth System is a fully integrated provider of high quality, highly compassionate health care services for all people at every stage of life. The heart of The MetroHealth System is MetroHealth Medical Center, a 731-bed teaching hospital and major regional referral site. Beyond the medical center, MetroHealth operates 13 inpatient and outpatient facilities throughout Greater Cleveland, including a comprehensive outpatient surgery center, two long-term care/skilled nursing centers, and 10 community health sites. Services include Level I trauma, burn, and critical care; women's and children's services, including high-risk obstetrical care and neonatal intensive care; heart and vascular care; cancer care; medical and surgical subspecialties; rehabilitation; long-term and skilled nursing care; and community health.

About SBC

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SBC Communications Announces Five-Year Contract with Indiana State University

SBC Companies to Provide Voice Services to Improve Communications for University

San Antonio, Texas, April 13, 2005

SBC Communications Inc. (NYSE: SBC) today announced a new contract with Indiana State University (ISU), a university located in Terre Haute, Ind., which offers more than 100 majors for more than 11,000 undergrad and graduate students.

Under terms of the contract, SBC companies will maintain ISU's entire voice network, including PBX maintenance, by providing SBC PremierSERVSM Voice CPE Support Services for innovative and reliable management of voice communications equipment, systems, and services.

The services will provide ISU with dependable and easily expandable communications for its 1,600 staff and faculty members as well as more efficient communications with other institutions and prospective students.

"At Indiana State, we want to help our students build a strong foundation for future success," said Timothy Cottom, assistant director of telecommunications and video engineering service, Indiana State University. "SBC companies allow us to do this by equipping us with the latest and most reliable services in voice technology."

"We are happy to be able to serve Indiana State University," said Cathy Coughlin, president, Business Communications Services, SBC Midwest. "Our voice services will provide the flexible communications the university needs while optimizing network availability and performance."

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